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THE STRUCTURE OF THE ONTARIO RETAIL SALES TAX ACT

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THE STRUCTURE OF THE ONTARIO

RETAIL SALES TAX ACT

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SUMMARY OF CONCLUSIONS AND RECOMMENDATIONS

For purposes of convenience, a summary of the conclusions and recommendations included in the study together with references to the pages on which these recommendations are discussed is set out below:

1. Sales or consumption taxes should be levied at the retail stage, i.e. at the point where goods are sold to a consumer. Pages 6-9.

2. A single stage tax is preferable to either an added-value tax or a turnover tax. Pages 11-16.

3. If the federal government imposes a tax at the retail level it will be essential for the federal and provincial governments to co-operate in the administration of sales taxes. Pages 17-18.

4. Even if the federal government does not impose a retail sales tax, there should be more co-operation between provinces in the administration of provincial sales tax. Pages 18-19.

5. The Act should be changed so that tax is levied on goods imported into Ontario and new goods sold at a retail sale in Ontario. Pages 32-35.

6. Tax should be levied on services as well as on tangible personal property. The tax on services should not be a general tax but should be a tax on specific services. Pages 35-37.

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17. Construction contractors should be deemed to be the vendors of tangible personal property and hence licenced so that they may purchase materials free of tax. Contractors would be required to collect tax from the owner of the property, using a percentage rate which would be applied to the total contract price. An appropriate rate might be 1.25%, which would be equivalent to a 3% rate applied to the material content of the contract. Pages 45-48.

18. The present deposit or bonding requirements for non-resident contractors appear to be excessive. Pages 48-49.

19. A number of recommendations have been made respecting technical changes which should be made in the Act for purposes of clarity or to reduce the possibility of undesirable administrative practices. Pages 49-55.

20. Steps should be taken to relieve the critical shortage of tax auditors, which until now has prevented the implementation of an adequate enforcement programme. Pages 58-61.

21. The Province of Ontario should not adopt a municipal sales tax similar to that formerly imposed by Quebec municipalities. If a municipal sales tax is required it should be levied on a uniform basis by the Province and revenues should be allocated to municipalities on a formula basis. Pages 62-65.

INTRODUCTION

The Ontario Committee on Taxation has commissioned this study on the Ontario Retail Sales Tax Act as part of its inquiry into the taxation and revenue system of the Province of Ontario. The specific terms of reference under which this study has been made are as follows:

(a) The preparation of a detailed description of the present operation of the Ontario Retail Sales Tax Act and Regulations.

(b) An analysis of the Ontario Retail Sales Tax Act, Regulations, Rulings and administrative practices with regard to simplicity, clarity and efficiency, and an examination of the presence and effects of anomalies and inequities therein.

(c) The consideration and description of alternative consumption taxes, such as turnover and added-value taxes.

(d) The preparation of a detailed description of the present operation of a typical municipal sales tax in the Province of Quebec, with consideration being given as to the ease or difficulty of application.

(e) The development of appropriate recommendations to improve the present system.

While this study is to be concerned with the structure of consumption taxes rather than with economic policies it is nevertheless important to consider certain matters falling within the framework of an economic study in order to have some standards against which the tax and recommendations for changes in the tax can be measured. A few comments on taxation generally and the attributes of a good taxation system are therefore set out as a background against which to discuss the Ontario retail sales tax.

One of the main functions of government is to determine a method for distributing the costs of public service within the private sector of the economy. Not only does this require an equitable distribution of costs among the various economic groups within the private sector, it also requires an allocation of costs between present and future generations.

Having first determined what the equitable distribution of public costs should be, government must then develop a taxation system which is consistent with this objective, for it is primarily through taxation that government revenues are raised. The requirements of a tax system then are two-fold. First, it must raise revenue sufficient for current public services. Second, it should require each individual member of the society to bear his equitable share of the total tax levy. It is difficult to determine what the equitable share of the tax levy should be for any particular member of society. This will depend to some extent upon two factors: the ability of the person to pay taxes and the benefit he receives from the public services. The more affluent members of society are expected to pay more for the support of the government than those members on whom fortune has not smiled and who can afford to pay taxes only at minimal levels.

Ability to pay taxes may be measured in many ways. Most frequently however, it is based upon the taxpayer's income in excess of a basic minimum required for his support and for the support of his dependents, and his total wealth. The taxpayer's expenditure may not as easily be taken as a measure of his ability to pay taxes since expenditure does not usually keep pace with increasing income and wealth, at least at higher income levels.

Taxes imposed in Canada, as in most developed countries, fall largely into four categories. These categories are income taxes, consumption taxes, wealth taxes and property taxes. In addition, there are many other taxes, licenses and fees imposed by municipal, provincial and federal governments in Canada and elsewhere which, while probably important in terms of total revenues raised, are not of general economic significance if viewed individually. We would consider mining taxes, motor vehicle permits and municipal licenses as typical of this sundry category.

1. Income taxes. This is perhaps the most common type of tax, at least in developed countries. It is by its structure a complicated tax in that it requires both the definition and the measurement of income. A tax on income attempts to measure the ability of an individual or other person to pay tax by reference to the income received by that person which is available either for saving or for consumption. Since it is generally accepted that as income increases, tax-paying capacity increases more than proportionately, rates of tax frequently increase as income increases. Where this occurs, the tax is said to be "progressive".

2. Consumption taxes. Taxes on consumption are the second major category of tax. These include the federal sales and excise taxes, gasoline tax, liquor taxes, as well as the provincial retail sales tax. Unlike the tax on income, consumption taxes attempt to measure the taxpayer's ability to support the government by what he spends on himself. However, in practice, all consumption taxes provide for at least some exemptions. Therefore the amount of tax paid by each taxpayer on what he consumes is susceptible to some extent to personal choice.

   A general tax on consumption that does not provide any exemptions would absorb a greater portion of the resources of low income groups than high income groups since those with low incomes generally spend on consumption a larger portion of their income than those with higher incomes. A general consumption tax would thus be said to be "regressive".[1]

3. Wealth taxes. Taxes on wealth measure the ability of the taxpayer to support the government by reference to the assets which he has accumulated. Estate tax and succession duties are the principal wealth tax in Canada. Some countries, however, have adopted annual taxes on wealth.

4. Property taxes. Property taxes form the basis for most municipal taxation in Canada. Such taxes attempt to measure the ability of persons to pay tax by reference to ownership of property. As such they may be regarded as a form of wealth tax, although ownership of real property cannot be considered to be an accurate measure of wealth, since it does not give consideration to the owner's equity in the property, nor to his other assets.

As noted above, some of the types of taxes are not related to the ability of the taxpayer to pay nor are they directly related to the benefits

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1 Since retail sales taxes generally exempt such items as food, fuel and housing, these taxes are in fact somewhat progressive. See Irving J. Goffman, The Burden of Canadian Taxation (Canadian Tax Foundation, 1962) page 22.

received. However, the first three types of tax (income taxes, consumption taxes and wealth taxes) if taken together, fulfill the requirements of an equitable tax system. Any system that ignores any one of these three types of tax may involve some degree of inequity. For example, a tax system that taxes both income and consumption but ignores taxes on wealth places an undue burden on those persons who through necessity or choice spend their whole income on consumables. It grants an unfair advantage to the thrifty person who manages to save a substantial part of his income since the savings do not bear any tax. Similarly, a system that taxes income and wealth and does not tax consumption is an unfair advantage to those spendthrifts who consume all that they receive in such a way that they never accumulate any wealth. It can be seen that a tax on consumption should be an integral part of any taxation system in order that equity may be achieved.

Having established that an equitable tax structure should include these three basic tax forms, consideration must then be given to the rate structure of each tax, since equity is logically dependent upon the relative impact of each tax form. One cannot intelligently comment upon the equity or lack of equity inherent in one particular tax without first considering the impact of all of the other taxes imposed upon the community.

It is, however, beyond the scope of this study to attempt to determine what the rate structure should be for each tax in order to raise a given amount of revenue.

In the preceding paragraphs we have concluded that consumption taxes form an important part of any taxation system. Consumption taxes can take a number of forms from special taxes on specific commodities to general taxes on all commodities and such taxes may be levied in a variety of ways and at a number of different points in the distribution system. Each such variation in the type of commodity tax has its own particular advantages and disadvantages. In order to judge these various forms of tax it is necessary to set out some general principles of taxation against which any tax can be measured.

The first recognized principles of taxation were set out by Adam Smith in his "Wealth of Nations" written in 1776. These principles, which are still accepted today, include equality of burden in accordance with ability to pay, certainty of application, convenience in the time and manner of payment and simplicity and economy of administration and collection. Modern economists have added additional principles, including elasticity, neutrality, social acceptability and reliability of yield. While all these principles must be present in any good taxation system, it is not possible that each single tax should qualify equally under each of the principles outlined above.

Since no single tax can meet all of the principles, it is clear that any system of taxation which is judged by measuring each individual type of tax against the present standards will appear on such an examination to be at best a mediocre system. However, the system taken as a whole may very well meet every one of the principles set out above and therefore while each individual tax may be considered to have serious shortcomings, the taxation system as a whole may in fact be acceptable or even admirable.

Even if each individual tax cannot be judged against all of the principles set out by economists, it may nevertheless be tested by the following precepts in order to determine whether or not it can qualify as a good tax.

1. Certainty. Very little needs to be said about this principle other than that without certainty the position of both the tax gatherer and taxpayer is impossible. Wherever the rate of tax or the subject matter of the tax is capable of arbitrary determination by the taxation authorities, certainty is sacrificed. The tax should therefore be based upon well-defined rules set out in the appropriate taxing statutes and discretionary powers exercisable by the tax gatherer should be avoided. Insofar as is possible, legislators should resist the temptation to be continually making changes in the tax structure unless there is some real need for change.
2. Simplicity. The legislation imposing the tax should be easy to understand and be written insofar as possible in non-technical language. It may be argued that it is not possible to devise simple legislation to deal with extraordinarily complex transactions which are an ordinary part of modern business. While this is true, it should nevertheless be possible to devise legislation that would achieve the desired results or at least to prepare detailed regulations and explanations of the law so that even persons of relatively humble education may be able to comply with the law without the expense of obtaining expert guidance in order to clarify their position. It should also be noted that the more complex the law the more chances there are that taxpayers will be unable to determine whether or not they are complying with it. Accordingly, the problems of administering the law become much greater and serious financial problems might result for those who in ignorance have failed to collect or pay the proper amount of tax.
3. Effectiveness. There should be no room for taxpayers to circumvent the tax law and thus obtain an unintended advantage over competitors or fellow taxpayers. Where "loopholes" develop in the law, disrespect for the law grows and the task of the tax gatherer is made much more difficult. In addition, the existence of loopholes encourages taxpayers to turn their attention to defeating the tax and a great deal of socially unproductive labour may be expended in this direction. This has the double fault of removing intelligent minds from productive paths and also tends to reduce the flow of revenue to the government.
4. Neutrality. Taxation should be as neutral as possible. That is to say, business or personal decisions should not be dependent upon tax considerations. The tax imposed on a given business transaction should be the same regardless of the method followed in completing the transaction. Similarly, there should be no tax distinction between directly competing products or between similar products sold by competing manufacturers simply because one organizes his business affairs in a different way from another.

   Few tax systems, however, can be entirely neutral. Certain social objectives are frequently sought through the medium of the taxation system. For example, it is generally considered acceptable that heavy taxes should be levied upon alcoholic beverages while essential foods should be exempt. It is not, however, the purpose of this study to consider the merits of using a tax system as a tool for the accomplishment of purely social objectives.

5. Economy of collection. It is essential that any tax should be capable of being collected without a great deal of administrative effort and inconvenience. In considering economy of collection attention must be directed not only to the cost incurred by the tax gatherer in administering the tax, but also those costs incurred by the taxpayer. In many cases it is possible to frame tax legislation in such a way that the administration of the tax by government officials is kept to an absolute minimum. This is frequently done however, at the expense of the taxpayers who may be obliged under the statute to incur substantial bookkeeping and other administrative functions in order that the government administration may be kept to a minimum. For example, in order that administration of the income tax may be kept as simple as possible, many persons are required to make a substantial number of reports to the government relating to such items as wages, rents, interest, dividends, and other amounts paid to other taxpayers. Furthermore, business enterprises are responsible for collecting significant amounts of tax and remitting it to the tax authorities on behalf of other persons. In many cases the responsibility placed on businessmen in connection with taxes can be handled as a matter of routine and while they add to the administrative burden, the costs of compliance may not be as severe as it would appear at first glance. In other cases, however, the costs of compliance may be very great indeed. For example, in the case of a sales tax, if the exemptions from tax are complicated or difficult to understand, the costs to the taxpayer of collecting and reporting the tax may be very high. Furthermore, the costs of assessing the tax may also be high.

It will be noted that the principles outlined above are to a considerable extent interrelated. For example, the simpler the structure of the tax the more likely it is to be certain and also to be effective. Furthermore, a simple tax is more likely to be easy to administer than a more complex tax. Similarly, a tax that is levied on a reasonably broad base (that is, a tax that has a very wide impact and permits few if any exemptions) may be collected economically and is more likely to be neutral in its effect on competing products.

In this study we will be concerned primarily with measuring the Ontario retail sales tax against the principles set out above. Before discussing in detail the present Ontario tax and testing it against these principles, it is proposed to review the basic form of the present tax and to compare alternative forms to see whether one of the latter may not be preferable in the circumstances.

COMPARISON OF VARIOUS CONSUMPTION TAXES

In the terms of reference under which this study is being conducted, item (c) includes "the consideration and description of alternative consumption taxes, such as turnover and added-value taxes". There are, of course, a very wide variety of consumption taxes which fall into a number of categories. This study is concerned only with the general consumption tax and no consideration has been given to specific taxes such as gasoline tax and other taxes of this nature.

Within the area of general sales taxes there are a number of different types of taxes which may be levied at various points in the distribution system. There are three basic types of tax: the single stage tax, the turnover tax, and the added-value tax. Each of these taxes may be levied at a number of points in the distribution system, including the manufacturing stage, the wholesaling stage, and the retailing stage.

The Ontario retail sales tax is not in reality a retail tax (i.e. one based upon the gross receipts of a retailer) but is rather a tax on the consumer or user of goods levied in respect of his consumption or use. Although the tax is generally levied at the time of a retail sale, it is not the retail sale of an article which is taxed but rather its consumption or use. For most practical purposes, however, the Ontario tax may be regarded as a retail sales tax, that is, a single stage tax levied at the retail stage although, in a few minor but important aspects, this is an over-simplification of the effect of a tax on the consumer as opposed to a tax on the retail sale.[1]

Before embarking on a discussion of the various types of tax it may be useful to discuss briefly the problems and advantages of levying the tax at the various points in the distribution system. As noted above, tax may be levied at the manufacturing, wholesaling, or retailing stages. At the present time, we understand that only a tax at the retail stage is open to the provinces because of the restrictions on the taxing powers of the provinces contained in section 92 of the British North America Act. A discussion of taxes at other stages, therefore, may be somewhat academic but since it is possible that the British North America Act could be amended to grant the provinces power of indirect taxation, the question of the point at which tax should be levied cannot be ignored.

In describing the advantages and disadvantages of imposing tax at various points in the distribution system, the question of the tax rate has not been considered. It has been assumed that the rate of tax is determined by reference to the size of the tax base and to the government's decision as to the amount of revenue to be raised from a consumption tax.

Manufacturers' sales tax

A sales tax levied at the manufacturing stage has one major advantage over taxes levied at other stages. The number of taxpayers is reduced to an absolute minimum and these taxpayers, generally speaking, maintain adequate records. Problems of administration are therefore minimized, at least insofar as the actual collection of the tax is concerned.

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1. See also page 9

There are, however, a number of problems that arise in the tax at the manufacturer's level. Business operations are very complex and it is difficult in many cases to determine whether a particular operation is a process of manufacture or not, e.g. manufacturing vs. construction. Problems also arise in the area of packaging and assembling in determining whether tax should apply after the packaging or assembly or before.

It is also necessary to determine the value on which tax is to be levied. Manufacturers sell their products in a variety of different ways, some manufacturers selling to wholesalers, others to dealers and still others selling their product directly to the public. In order to avoid the application of tax to selling costs where the manufacturer does not sell his goods directly to wholesalers, special formulae must be worked out. Inevitably, the calculation of taxable value by reference to formulae leads to grave complications in the administration of the tax. Furthermore, in spite of the best efforts of the taxation authorities, a tax at the manufacturing stage is certain to have a distorting effect upon the competitive position of similar goods, because of differences in the methods used in distributing these products.[1]

Certain special problems arise in the case of a manufacturer's sales tax levied by a provincial government. Because there are no tariff barriers between provinces, complicated collection procedures would be required in order to collect tax on merchandise manufactured outside of the province and imported for sale in the province. Similarly, procedures would be required to refund taxes paid on merchandise manufactured or assembled in the province but sold in other provinces. Refunds would be particularly difficult to determine when the goods were exported by wholesalers or retailers, who would not normally be aware of the amount of tax paid by the manufacturer.

The administrative problems associated with interprovincial trade alone are serious enough to make a manufacturer's sales tax impractical at the provincial level. The more general difficulties associated with such a tax (valuation problems and the distorting effects upon competing products) serve to confirm this conclusion.

Wholesalers' sales tax

As compared with the manufacturers' tax under which only manufacturers need be concerned with the tax, a wholesalers' tax involves both

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1. In this discussion, no consideration was given to the criticism frequently levelled against sales taxes imposed at an earlier point in the distribution system to the effect that subsequent distributors will take a mark-up on the sales tax content in the cost of the merchandise (the so-called "pyramiding" effect). There is some justification for this criticism since the costs of financing, insurance, etc. will be higher because of the sales tax content of inventories. Aside from the additional inventory costs, however, there should be no difference in the price paid by the consumer under a manufacturer's sales tax system and a retail sales tax system. Any other conclusions can only be based on the premise that Canadian wholesalers and retailers are making an excessive profit at the present time by virtue of their mark-up on the federal manufacturers' sales tax. In a competitive market this situation cannot exist. It has been argued that competitive forces may take time to become fully operative, and hence some short term pyramiding of the tax might result from price changes. However, the amount of this pyramiding of tax cannot be significant since it would represent at the most only a percentage (i.e. the tax rate) applied to the percentage of the price increase. At the same time, the whole increase in the price works to increase competition and to reduce mark-ups. In any event, the "pyramiding" argument is highly theoretical since it overlooks the price policies followed in practice by retailers on the bulk of their sales to consumers. Very few goods are sold by retailers at prices which are determined by applying a fixed mark-up to their purchase price.

manufacturers and wholesalers in the tax machinery. Since almost all manufacturers make some sales to dealers or consumers, it would be necessary for all manufacturers to be licensed and to be involved in the charging and collection of tax. Thus the principal advantage of the manufacturers' tax in having a small number of taxpayers is diluted. If the point at which tax is levied is moved to the wholesale stage, the distorting effects found in the manufacturers' tax are alleviated to some extent. Distortions arise because of the variety of channels of distribution and the deferring impact of the tax on each channel. Under a wholesalers' tax the number of different channels is reduced with a resulting decrease in distortion. Furthermore, the tax base is broadened and the rate of tax is therefore lower, which would further tend to decrease distortions. In the case of imported goods, the chances of distortion are substantially reduced since few consumer goods are imported by users and in these cases distortions would not have any overall significance. However, it would be wrong to conclude that distortions would be eliminated in a wholesalers' tax - particularly in the case of domestically-produced goods.

The problems concerning interprovincial transactions noted above in the case of a manufacturers' sales tax would be reduced somewhat in a wholesalers' tax. Nevertheless wholesalers are by no means restricted to dealing within their own province and the same problems of collection of tax on goods imported into the province and refunds of tax on goods exported from the province would continue to exist.

The administrative problems associated with interprovincial trade would continue to be so great under a wholesalers' tax as to make it equally impractical at the provincial level. In addition the wholesalers' tax does not appear to have any significant advantage over the manufacturers' tax either with respect to ease of administration or the avoidance of distortion problems.

Retail sales tax

In the case of a sales tax at the retail level the most serious disadvantage is the number of taxpayers who must be concerned with the tax. Virtually all business enterprises (other than those dealing purely in services) would be required to have licences. The records of some retailers are rudimentary and therefore auditing is made more difficult. While much is made of this latter argument by opponents of the retail tax system, it must be remembered that the great bulk of all retail sales are made by substantial businesses whose records are likely to be at least as good as those of many manufacturers and wholesalers. The problem of poor records on the part of retailers then may be somewhat overstated by opponents of the retail system.[1]

The chief advantage of a retail tax is that the distorting effects found in taxes levied at earlier points in the distribution system are almost totally absent in a retail tax. The tax is levied on the price that the consumer pays for the goods. Since the tax is levied on the price paid by the consumer the tax content of the purchase price will not be affected by varying channels of

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1. We have summarized in Appendix C, 1961 census figures prepared by the Dominion Bureau of Statistics showing the volume of retail sales in Ontario by classification and volume of business per retail establishment. These figures show that 89% of retail sales (excluding food) were made by individual establishments whose annual sales volume is in excess of $50,000. 74% of retail sales were made by individual establishments whose annual volume is in excess of $100,000. We believe that establishments with annual sales in excess of $50,000 per year may be expected to maintain reasonable records and establishments with annual sales in excess of $100,000 may be expected to maintain good records.

distribution. The amount of the tax on imported goods will be the same as on domestically produced goods. The tax on competing goods will be different only because of price differences.

The problem of interprovincial transactions still exists with a retail sales tax, but the severity of the problem is reduced. So far as the tax affects individual consumers, the problem is significant only in border areas since most purchases by individual consumers are made locally. There remains, however, a serious problem because sales by vendors outside the province, of goods delivered in the province, escape tax and therefore some revenue loss can be expected. Problems also arise in cases where goods are used in one province and then moved to another province. In these situations, tax may be levied by both provinces. This problem is discussed in greater detail in the section "Co-operation with other governments".

Because the manufacturer's tax and the wholesaler's tax both involve substantial administrative problems aside from the problem of collection and because both have a distorting effect on the competitive position of similar products, taxation at these levels is less desirable than tax at the retail level. It is true that the administrative problem of dealing with the large number of retailers would appear to be greater than the problem of dealing only with manufacturers or manufacturers and wholesalers. On the other hand, the direct costs of collecting the provincial taxes now in effect in Canada, which represent some measure of the problems involved in administering a retail tax, are generally considered to be reasonable.[1] On balance therefore, a tax at the retail level is preferable to a tax at either the manufacturers or wholesalers level. In the case of a provincial sales tax the problems of inter-provincial trade make it almost essential to have the tax at the retail stage.

Types of retail sales taxes

In our discussions up to the present we have treated retail sales taxes as being of one type only. In fact there are a variety of taxes which may be imposed at the retail level.

In the Canadian provinces and in some of the states of the United States, the tax is imposed upon the consumer or user of taxable property. For administrative reasons, retailers are, in effect, only collecting agents for the tax. In other states of the United States, the tax is imposed upon the retailer, based upon his gross receipts from the sale of taxable property. (Some of these states, however, require that the tax be passed on to the purchaser as a separate item and hence are somewhere between a true gross receipts tax and a consumer tax.) These two forms of tax may be referred to as "consumer taxes" and "gross receipts taxes" respectively.

In Canada the user or consumer taxes have been adopted because of the constitutional requirements that provincial governments may levy only direct taxes. Since it is clear that a sales tax levied at the retail stage is intended to be shifted to the consumer and borne by him, the tax would only qualify as a direct tax if it is levied directly upon the user or consumer of taxable goods. If a gross receipts tax is levied on retailers and is passed on to the consumers, it would be regarded as an indirect tax and hence ultra vires of a province.

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1. John F. Due, Provincial Sales Taxes (Canadian Tax Foundation, 1964) page 150

The differences between the two taxes so far as government administration is concerned are relatively minor. Essentially the same problems exist in administration and enforcement under either type of tax since in both cases the government will look to the retailer for the payment of the tax. In the case of the user or consumer tax, the vendor is required to act as agent for the Crown in the collection of tax and failure to collect the tax renders him liable for it. In the case of the gross receipts tax, the tax is levied on the retailer in respect of his sales. In either case it is the retailer who remits the funds to the Crown and in either case the tax is expected to be fully shifted to the consumer or user.

There are, however, a number of minor differences between the two types of tax which should be noted. Under the consumer type of tax only sales of sufficient size to attract at least a half a cent of tax would normally be subject to tax, for example, with a 1% rate, sales below the level of 50¢ would not normally be taxable since the amount of tax would be less than one-half of one cent. In the case of the Ontario tax where the rate is 3%, the smallest sale which would be subject to tax under this system would be 17¢ on which the tax would be .51¢. (In Ontario this is varied by statute to a minimum taxable sale of 21¢.) Under the gross receipts tax there would be no sale so small that it would not be taken into consideration in computing the liability of the vendor. Because of this most gross receipts taxes provide for a bracket system for the collection of tax by retailers. Under this system the tax collected on smaller sales is greater than the amount determined by multiplying the amount of the sale by the tax rate and rounding to the nearest penny.[1] The effect of this, if the bracket system is properly designed and takes into consideration the main price points used by retailers, is that the retailer will collect approximately the same amount of tax from his customers as he is required to pay. The amount he is required to pay, however, will not depend on his collections but will be determined by applying the tax rate to his gross taxable sales (i.e. sales of non-exempt goods). It follows, of course, that government revenues from a gross receipts tax will be higher because of the inclusion of <u>all</u> taxable sales in the tax base rather than just those in excess of a specified minimum amount.

From the point of view of the retailer there are certain advantages to the gross receipts tax as opposed to the consumer tax. The greatest single advantage lies in not being required to keep detailed and accurate records of the amounts of tax collected from customers. This advantage exists only so long as the bracket system is properly set up. Errors in the bracket system could lead either to the retailer paying more tax than he recovers from his customers or to the retailer making a profit on the tax.

Where a user or consumer tax is in effect the retailer will be required to keep accurate records of the tax collected. In the initial circumstance this can be an expensive problem for the retailer who may be

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1. In his book "State Sales Tax Administration", John F. Due has set out a table comparing the bracket systems used in a number of states. In a substantial number of cases the brackets at the lower levels of tax for sales of small amounts are set quite differently from the brackets that would be set under the major fraction rule used by Ontario. In many cases amounts below the minimum amount for a 1¢ tax are specified in the bracket table and the 2¢ tax comes into effect at an amount below the minimum amount under the major fraction rule.
   See John F. Due, <u>State Sales Tax Administration</u> (Public Administration Service, 1963) pages 143-144.

required to purchase new cash registers or at least change over his existing registers to make provision for recording the tax. Summaries of tax collections must be maintained in the accounts and balance with the cash. However, once such a system has been instituted, it is doubtful if there is any significant advantage to retailers through changing the form of the tax to a gross receipts tax since many of the substantial costs involved in accounting for tax relate to the mechanical equipment necessary. In those larger establishments where the accounting costs may be significant, it would probably be more efficient both from the point of view of the retailer and the government to establish a formula basis for the payment of tax which would be checked from time to time by reference to actual tax collections. Thus in practice the advantages of the gross receipts tax could be attained for the large retailer who did keep adequate records.

There is one further minor advantage that might be claimed for the gross receipts tax. Under the consumer or user taxes now in effect in Canada the governments invariably remunerate the vendor for his work in acting as a collection agent. Under a gross receipts form of tax there would be no basis for the payment of vendor remuneration and this troublesome and expensive part of retail sales tax collection could be abolished. We deal more fully with the question of vendor remuneration later in this report.[1]

Because of the constitutional requirements mentioned earlier, all retail level sales taxes in Canada are levied only upon consumers. There is a distinction however which may be made between consumer type taxes levied only on retail sales of taxable property (a true retail sales tax), and consumer taxes levied in respect of the consumption of taxable property (a consumption tax). The present Ontario tax falls into this latter category.

If tax is levied upon the consumption or use of goods on the basis of the price paid for them tax may apply many times to the same article. This duplication of tax is almost certain to occur in the case of automobiles, works of art, furniture, appliances, stamp and coin collections, etc. While these are the obvious examples, there are any number of goods which may be used by more than one person and therefore may be taxed more than once.

A true retail sales tax applies only to retail sales (and importation) of taxable goods. Used goods purchased by one individual from another in a casual sale would not attract tax. However, the vendor in a casual sale will attempt to pass on a portion of the tax which he paid when the goods were first purchased. In most cases, the value of a used article will be related in terms of its condition, age, etc. to the tax-paid value of a similar new article. In this way the tax is shifted from purchaser to purchaser and each bears an amount of tax correlated to the value of his use of the article. Thus, a retail sales tax which does not tax casual sales provides a better measure for taxing the consumption of durable goods.[2]

Turnover taxes and added value taxes

As noted earlier there are three basic types of tax on consumption. These are the single stage tax, the turnover tax and the added-value tax. The single stage tax is applied at a particular point in the system of production

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1. See also page 54
2. See also page 32

and distribution of goods and is intended to apply to any particular product only once. In the case of a manufacturer's tax the tax applies only to fully manufactured articles and would not apply to partly manufactured goods or raw materials. Once the article has been completely manufactured and tax applied it would then enter the distribution scheme and no further taxes would be payable. In the case of a retail tax or consumer tax, tax would not be payable until the time the goods were sold to a purchaser for use or consumption. It is therefore necessary for each sale to determine whether the goods are being sold for consumption or use or whether they are to be resold or incorporated into some other product. This gives rise to some administrative difficulties for both the tax authorities and for vendors.

The turnover tax is levied at each point in the production and distribution process at which the sale occurs. Thus there would be no exemption for raw materials, partly manufactured goods, etc. The rates of tax would be a good deal lower than under a single stage tax since the tax will be compounded. Administration and collection of this type of tax is very simple since it applies to all sales. However, such a tax is obviously inequitable since it penalizes taxpayers who do not concentrate production and distribution facilities within a single unit. While it would be impossible for most manufacturers to fully integrate their distribution system, there would be a strong incentive towards integration of production and distribution facilities particularly if the rate of tax were substantial.

The added-value tax attempts to achieve the administrative efficiency of the turnover tax along with the more equitable taxation achieved by the single stage tax. Tax is levied at the time of each sale in the production and distribution process on the increase in the value of the goods as they pass through the particular stage. In practical terms each taxpayer pays full tax on his sales but receives credit against this tax for taxes included in his purchases. The tax therefore applies only to the value added to the goods by the application of labour and capital. Because each manufacturer or vendor receives credit for the tax element in goods he purchases there is no compounding of the tax. If, however, it is decided to levy tax in respect of any of the elements of the cost of manufacture or distribution it is necessary to establish some method for making sure that credit is not claimed for the tax paid on these elements. If, for example, it is desired to exempt production machinery and apparatus this may be accomplished by permitting manufacturers to recover tax paid on their purchases of machinery and apparatus from the tax accruing on their sales. If it is decided that machinery and apparatus should not be exempt then manufacturers will not be permitted to recover the tax paid on purchases of machinery and apparatus out of the accruing taxes on sales and some administrative difficulties will arise. It should be noted that the amount of revenue raised and the effect of the tax on the price paid by consumers is identical under an added-value tax carried to the retail level and a single stage retail sales tax provided the rates are the same.

The disadvantages of turnover taxes are now widely recognized.[1] While there may be some administrative advantages to the elimination of

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1. The disadvantages of turnover taxes are discussed in some detail in the report of the Committee on Turnover Taxes appointed by the Chancellor of the Exchequer of the United Kingdom dated February 21, 1964.

exemptions through the use of a turnover tax, these advantages are minor in comparison with the distorting effect that such a tax has upon the manufacturing and distribution processes and its uneven impact on competing goods and services. We do not consider the turnover tax to be appropriate for the Province of Ontario and consequently for the purposes of this study we have rejected it.

The choice between the single stage tax and the added-value tax however is neither clear nor easy to make. The added-value tax has received a good deal of publicity in recent months due to the recommendation that it be adopted by all members of the O.E.E.C. Proponents of this system believe that it is far superior to any other type of consumer tax and there has been some suggestion that it should be adopted by Canada and by the Canadian provinces. Such suggestions have come from well informed and responsible persons who sincerely believe that the added-value tax has many substantial advantages over a single stage tax, and their views cannot be ignored.

One of the major advantages which has been claimed for the added-value tax is that it can be used as a partial substitute for taxation of business income. When used in this way the added value tax is said to be far superior to the income tax since it takes no account of business efficiency and whether or not a business is profitable. While this may be a fair statement, the advantages claimed for the added-value tax are present in any other form of sales tax and the added-value system cannot be said to have unique qualities in this area.

The added-value system, however, does have certain marked advantages where it is necessary to allocate revenue to various jurisdictions in which the economic activity occurs. Consequently, in the common market the added-value tax would be particularly appropriate since it permits each jurisdiction to obtain tax revenues based upon the economic activities carried on within its borders without having any regard to the locality in which the ultimate sale takes place. While this particular feature of the added-value tax would have certain advantages in Europe the same advantages do not apply when consideration is being given to a provincial sales tax. If the provincial sales tax were to be allocated in some way amongst the municipalities based upon the economic activity taking place within the municipality an added-value tax would certainly be one method of making the allocation. However, it is questionable whether such an allocation would be acceptable to municipalities other than the major centres such as Toronto, Hamilton, Windsor, etc. Rural municipalities would almost certainly suffer under such an allocation system.

The same argument may be made with respect to allocation of taxes as between provinces. In the case of the more heavily industrialized provinces there would be substantial advantages to an added-value system. However, for those provinces whose economy was of a more agrarian nature and those whose economies depended more heavily upon exports an allocation of tax revenues under an added-value system would be little short of disastrous. For these reasons the allocation features of the added-value tax do not seem to be important in the Canadian tax structure.

The comparison of the added-value tax with the retail tax must therefore be made on the basis of administrative convenience only. A comparison of the two taxes on this basis is fairly simple. Earlier in this study we outlined a number of tests against which a tax could be measured. The two taxes

are compared below against each of the tests.

1. Certainty. There is no real difference between the two taxes as regards certainty. Certainty depends entirely upon the way in which the law is written and is not a factor in determining whether one system is superior to the other.
2. Simplicity. From the point of view of simplicity the two taxes are almost identical. As in the case of certainty, simplicity will in most cases depend upon the way in which the law is written. However, within the narrow confines of the system itself, the single stage tax will have a slight edge in the area of simplicity since under the added-value system, it is necessary for each business to keep a record of its costs and the tax it has paid in order to obtain a deduction for them. This of course is partially offset by the difficulty of determining under a single stage tax whether any particular transaction is a retail sale or not and whether tax should apply.
3. Effectiveness. In the area of effectiveness the added-value tax has certain advantages. In the first place tax is collected stage by stage rather than all at once. Thus, if any vendor (and in particular, any retailer) fails to collect the tax, the impact on the revenue is not as significant. While tax will not have been collected on the retailer's profit it will at least have been collected on the retailer's purchase price. Accordingly, the inducement to avoid the tax may be somewhat less under an added-value system.

   While the added-value system has certain definite advantages under this heading, it should also be noted that these advantages are marginal. The great bulk of all retail sales are made by large and reputable organizations who have perfectly adequate records. Consequently, the problem of tax avoidance may not be so severe under a single stage tax as it would appear on the surface.
4. Convenience. Much has been made of the fact that the retail sales tax places the entire responsibility for the collection of the whole of the tax solely on the retailer. This argument, however, overlooks the fact that the retailer must collect the same amount of tax under both systems. Since the retailer collects the whole of the tax at the time of the sale under either system the responsibility placed on the retailer is no more severe under the retail tax system than under the added-value system. It should be noted, however, that under the added-value system each business must pay tax on its purchases. Thus, the inventory cost of manufacturers, wholesalers, and retailers will be increased by the amount of the added-value tax which they have paid. In the area of convenience then, it would appear that the retail tax has some slight advantage.
5. Neutrality. The question of neutrality is more a question of exemptions granted and the base on which the tax is levied rather than the method of collection of the tax. Therefore, there should be no difference between the two taxes in the area of neutrality.
6. Economy of collection. On balance it would appear that the retail sales tax has a slight advantage in this area. Under the retail system business enterprises would be required to collect and remit tax only in respect

or retail sales. On all other sales it is merely necessary for the vendor to obtain a certificate of exemption from the purchaser in order to sell the goods free of tax.

Under the added-value system, however, each business would be required to keep records of all of its purchases and all of its sales. Tax paid on purchases would have to be deducted from tax collected on sales in order to determine the amount to be remitted to the government. Inevitably under the added-value system, the records which must be kept by all businesses would be more complex and more subject to error. Accordingly, it appears that from the point of view of business a retail tax would be less expensive than an added-value tax to administer.

From the point of view of the tax authorities, the two taxes would appear to be about equal. Under either system all businesses would have to obtain licenses and books would have to be subjected to periodic audit. The added-value system might be slightly more difficult to audit since it would be necessary to examine both purchases and sales to make sure that the tax has been complied with and to be sure that no improper deductions for taxes paid on purchases were made. It is anticipated, however, that the difficulties of audit from the tax authorities' standpoint would be very little different under either of the systems.

Advocates of the added-value system have pointed out that exemptions for producers' goods are much more simple under the added-value system. Under the added-value tax each taxpayer simply offsets any tax he has paid on purchases against the tax he collects on his sales. Under this method it is possible to grant complete exemption on all producers' goods. If some degree of compounding of tax is thought to be desirable (e.g. through taxation of office equipment, etc.) the tax on articles to be so taxed is not offset against tax collected. It should be pointed out however that identical results may be obtained under the single stage retail tax either by defining retail sale in such a way that business purchases are not considered to be a retail sale or by granting exemption for all producers' goods. Again any desired compounding of the tax may be achieved by refusing to grant exemption for some producers' and distributors' goods.

In the comparison of the two taxes, the added-value tax seems to have advantages over the retail tax only in the area of effectiveness. In the other areas the retail tax is just as good and sometimes better than the added-value system. The question may therefore be logically asked, why does the O.E.E.C. prefer the added-value system? The answers to this are relatively simple. In the first place, the added-value system is already in effect in France. The other European countries have been using a turnover tax and are evidently aware of its shortcomings and deficiencies since they have agreed to adopt the added-value system. The added-value tax has other advantages which are very important. In the first place, it permits an allocation of revenue to various jurisdictions which is not possible under a single stage tax. It should also be noted that as used in France, the added-value system is not carried to the retail level, but rather stops at the point of sale from the wholesaler to the retailer. It is believed by many that compliance with the tax would be impossible if a single stage retail tax were introduced in view of the large number of small shops and the legendary resistance of the French

to the payment of taxes. (This latter factor is thought to be of less importance than the general point that the added-value system is already in existence in France and that the added-value system admirably meets the needs of the O.E.E.C.)

The factors which give rise to the acceptance of this tax in Europe are not present in Canada. A switch to the added-value tax would require the re-education of all business in Canada. The only advantage to be gained out of such a change would be the marginal advantage that tax avoidance would be made more difficult. Since this factor is not yet of critical importance in Canada there seem to be no compelling reasons to make the change. At the same time, from the Canadian point of view, the retail tax is equally effective and has certain advantages over the added-value tax in that the administration of the tax is somewhat more simple and tax is not levied until the goods pass to the final consumer. For these reasons it would appear that in Canada, the retail sales tax is, generally speaking, a better tax than the added-value tax.

CO-OPERATION WITH OTHER GOVERNMENTS

In the preceding section we have outlined the various types of consumption taxes and discussed the advantages and disadvantages of levying tax at various points in the distribution system. We have concluded that a single stage retail sales tax is the most appropriate type of consumption tax for provincial government purposes.

One of the outstanding disadvantages of the manufacturer's sales tax now imposed by the federal government when viewed from the point of view of a province is the difficulty of collecting the appropriate amount of tax on interprovincial transactions and on imported goods. No such difficulty faces the federal government in imposing its manufacturer's sales tax since it is able to control the collection of tax on imported goods. While the problem of interprovincial sales is a major problem, it is not the only difficulty inherent in a manufacturer's sales tax and we would not have recommended that the provinces levy tax at the manufacturers level even if there had been no problem in connection with interprovincial sales and imported goods. The other deficiencies of a manufacturer's sales tax are sufficient to weight heavily against any recommendation for its adoption.

It is important to note that while the federal manufacturer's sales tax is well administered, most of the difficulties outlined earlier exist in the present federal tax. Many recommendations have already been made to the Federal Royal Commission on Taxation to the effect that the federal sales tax should be changed to a retail tax. If the Federal Royal Commission were to make such a recommendation to the government and the recommendation were accepted, serious problems could result through the levying of two separate retail sales taxes in eight out of the ten provinces of Canada. It is inconceivable that the federal government would impose a separate retail sales tax with different exemptions and administrative rules from those imposed by the provinces. It therefore seems clear that the federal government could only levy a retail sales tax if it were to co-operate with the provinces and a combined federal and provincial retail sales tax were imposed.

While the terms of reference under which this study is being made contain no reference to the problems of a combined federal and provincial sales tax, the study would be incomplete if it did not consider the problems that would arise if the federal government imposed a retail sales tax. The problems are by no means insurmountable and in fact there would be substantial advantages flowing from co-operation of the federal and provincial authorities in the sales tax field One of the immediate results of the entry of the federal government into the retail sales tax field would be that it would be necessary for the federal and provincial governments to co-operate in the preparation of a uniform retail sales tax act. Some of the advantages that would flow from co-operation of the federal and provincial governments in a combined retail sales tax are outlined below.

1. While a sales tax is not an expensive tax to administer (ignoring vendor remuneration) there are at present time nine sales tax systems in Canada. The existence of differing administrative practices and rules between the provinces and the completely different system of taxation at the federal level results in some administrative confusion for taxpayers. It also results in a duplication of government administrative personnel. A uniform sales tax administration throughout Canada should reduce

substantially both government and business costs.

2. A uniform sales tax act with uniform administration across the country could reduce substantially the problems of tax avoidance where goods are purchased in one province for delivery in another in order to avoid provincial sales taxes. Similarly, the provinces could be assured of collecting tax on goods imported into Canada.
3. Under a uniform sales tax administration, it should be possible to avoid the present double taxation which results from transferring tangible personal property from one province to another.

While in the past the federal government has assumed responsibility for the administration and collection of any taxes which are levied on a co-operative basis by both the federal and provincial governments, there is no reason why a uniform sales tax could not be administered by the provincial governments if they so desired It would of course be necessary for the provinces to co-operate with one another in order to be sure that sales tax would be administered on a consistent basis across the country. At the present time however, there are two provinces which do not levy a retail sales tax and therefore have no body of administrative personnel available to collect a sales tax. Unless some arrangement were made with the governments of the Provinces of Alberta and Manitoba, it would be necessary for the federal authorities to maintain an administrative group to collect the federal tax in these provinces. Further, the Yukon and Northwest Territories must be considered. Unless special arrangements are made with the governments of the western provinces, the federal government will have to maintain an administrative force to collect tax in the Yukon and the Northwest Territories.

If efficiency and uniformity of administration were the only factors to be considered in selecting the most appropriate level of government to administer a combined retail sales tax the federal government would have to be chosen. There may be other considerations however including the fact that the personnel experienced in retail sales tax administration are now servants of the provincial governments that might balance the scales in favour of provincial administration. Under provincial administration the co-operation of the federal government would be essential particularly in the area of collection of tax on imported goods.

In discussing the possibility of a combined federal and provincial retail sales tax we noted that a number of advantages would flow from a uniform act and uniform administration. These advantages do not depend on combining the federal and provincial sales taxes. Most of the advantages could be obtained through co-operation of provincial governments alone.

The provincial governments now levying a sales tax should in future co-operate with one another more fully than they have in the past.

There are a number of problems which result from the differing provisions of the various provincial acts at the present time. One major disadvantage of the present provincial retail sales tax is that vendors find it difficult to comply with the varying exemptions and administrative procedures of the different provinces. This is true to some extent for any business which operates in more than one province. It is a serious problem for any mail order organization which attempts to collect tax for various provinces. It is also a serious problem for contractors who operate in more than one province.

Another major disadvantage is that the lack of provincial co-operation at the present time results in a substantial leakage of tax through residents of one province purchasing goods from a vendor in another province. Similarly, problems arise when goods which have been taxed in one province are transferred to another province and tax is levied a second time. These problems can all be eliminated if the provinces co-operate with one another in achieving a uniform sales tax act administered consistently in all provinces.

Early in 1963, the Province of Quebec amended its sales tax act to require that all vendors, wherever located must become licensed and collect tax on behalf of the Quebec government if they solicit orders from and deliver moveable property to residents of Quebec. Since the provincial courts will not enforce the revenue laws of another province this provision cannot be enforced. In order to overcome this problem, the Province of Quebec has enacted special legislation under which the Quebec courts will enforce the revenue laws of any other province which enacts reciprocal legislation. While the constitutionality of this Quebec legislation has been questioned,[1] it represents an important first step in that it indicates a willingness of one province to negotiate with other provinces methods of overcoming one of the serious problems of provincial tax administration.

While it is important to have provincial co-operation in the area of administration and collection of taxes, it is equally important that the provincial governments co-operate with one another in achieving just and equitable legislation administered on a uniform basis throughout all provinces. It is also important that changes of this nature be made slowly and with careful consideration being given to the possibility of future conflicts in taxing policies.

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1. While the question of constitutionality of the Quebec amendments is one which requires legal interpretation, it has been suggested that the requirement that retailers outside Quebec become licensed before shipping moveable property into the province represents an attempt to control economic activity outside Quebec and hence ultra vires of the province under the British North America Act. On the other hand, the Quebec legislation providing for reciprocal enforcement of the tax laws of other provinces, appears to be valid. (see paper presented by Stanley M. Beck to the 1963 Conference of the Canadian Tax Foundation - Report 1963 Conference (Canadian Tax Foundation 1963) pages 307-317).

STRUCTURE OF THE RETAIL SALES TAX ACT, 1960-61 OF THE PROVINCE OF ONTARIO

In the previous sections of this study we have discussed consumption taxes from a theoretical point of view only. We now turn our attention to the Ontario Retail Sales Tax Act and Regulations to assess the strong and the weak points in the legislation and to make suggestions for its improvement. In the following paragraphs we set out a description of the operation of the tax as it now stands and in a subsequent section we set out our criticisms and recommendations.

The present Ontario retail sales tax was brought into force on September 1, 1961 by "An Act to impose a tax on retail sales" included in the Statutes of Ontario, 1960-61. The Act is cited as The Retail Sales Tax Act, 1960-61. Despite the inferences which might be drawn from this name it is not a tax on retail sales but rather a tax on persons who acquire tangible personal property for consumption or use in Ontario. While the tax is normally levied at the time of a retail sale this is not the only type of transaction which gives rise to tax liability. The acquisition of taxable property by gift or by other means may result in tax liability for the person acquiring the property.[1] Property acquired outside the Province and imported into the Province is also subject to the tax.

Charging section

Tax is imposed by section 2(1) of the Act which reads as follows:

> "Every purchaser of tangible personal property shall pay to Her Majesty in right of Ontario a tax in respect of the consumption or use thereof computed at the rate of 3 per cent of the fair value thereof."

Tangible personal property

By definition, tangible personal property includes all personal property that is perceptible to the senses and specifically includes electricity, natural or manufactured gas and telephone services. Exemption from the tax is provided for many types of personal property and in addition certain persons are exempted from payment of the tax on property which they acquire for their own consumption or use. By regulation the Lieutenant-Governor-in-Council has ruled that tangible personal property does not include gold in its primary forms.

Since the tax is imposed only on the purchaser of tangible personal property no tax is levied on the following:

1. Services rendered separately and not forming a part of the purchase price of tangible personal property.
2. Stocks and bonds and other intangible personal property.
3. Real property, including homes and other real estate.

Tax on purchaser

The tax is imposed on every purchaser of tangible personal property. A purchaser is defined to include any person who on his own behalf or acting as agent for a principal acquires tangible personal property <u>anywhere</u> for consumption or use in Ontario either by himself or by others at his expense. Thus, the tax is levied regardless of where the purchase is made so long as the consumption or use is to take place within the Province of Ontario.

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1. See also page 44

The purchaser must acquire the goods for consumption or use in the Province either directly or at his expense for the tax to be exigible. Thus, a purchase of tangible personal property for resale is not subject to the tax. Similarly, a purchase of goods for consumption outside the province is not taxable.[1]

Fair value

The tax is computed on the fair value of tangible personal property purchased and, in most cases, fair value will be the price paid by the purchaser for the property. The Act for certainty provides that the fair value must include the value of all consideration accepted for the property including the value of services rendered and other things exchanged. The cost of or charges for customs, excise and transportation must also be included together with the cost of installation unless a separate charge is made for installation.

Finance, carrying charges and interest:

The fair value of tangible personal property does not include financing charges in cases where such a charge is made in addition to the usual or established cash sale price and provided the amount of such charges is separately indicated on the sales invoice.

Delivery charges:

Transportation charges may be excluded from the fair value if the tangible personal property is sold "f.o.b. supply point" and the transportation cost is either paid by the purchaser or if prepaid by the supplier is indicated as a separate amount on the sales invoice.

Installation and service charges:

If the sale price of property includes an amount to cover installation, service, etc. the full amount of the sale price will be subject to tax. If, on the other hand, charges for installation, service, etc., are indicated separately on the sales invoice and not included in the contract price, such charges are not subject to tax.

Trade and cash discounts:

Trade discounts deducted on the sales invoice may be excluded from the determination of fair value as may cash discounts taken at the time of payment in accordance with the arrangements set out at the date of sale. Quantity discounts or volume discounts allowed subsequent to the time of sale and premium stamps or coupons may not be deducted in the determination of fair value.

Production for own use:

Where a person produces goods for his own use and not for sale the tax applies to the cost of the goods. The costs of materials, labour, manufacturing overhead and federal sales and excise taxes would be included in cost for purposes of determining the amount to which the tax applies.

The term fair value is further modified by section 2(4) of the Act which permits the Comptroller to determine the fair value of property for purposes of tax computation where he deems it necessary or advisable.[2]

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1. See also page 43
2. See also page 53

Trade-ins, barters and exchanges

Under the Act the fair value of property includes all goods exchanged for the property at the time of sale. The Act varies these provisions somewhat by providing that where property is tendered in trade, tax will apply only on the difference between the value of the property acquired and the credit allowed for the property traded in. By regulation this provision for trade-in allowances has been limited to goods of the same general character and kind as the tangible personal property which is being purchased. In the case of a barter or exchange of goods, tax applies on the fair value of the goods being sold with no deduction for goods accepted in exchange.

Time of payment and remittance of tax

Where goods are purchased at a retail sale in Ontario liability for tax arises at the time the goods are purchased. Liability is not affected by the fact that credit is extended by the supplier to his purchaser In the case of goods imported into Ontario, the Act requires that the importer report the importation and pay the tax.

In order to facilitate collection of the tax vendors of taxable goods are required to collect the tax from the purchaser as agents of the Crown at the time of the sale. Taxes collected or collectible by vendors must be remitted to the Comptroller on or before the 23rd day of the month following that in which the liability for tax arose. As indicated previously the fact that credit is extended does not affect the liability for tax and such tax must be remitted by the vendor even though he has not yet fully collected his account with his purchaser. No relief is provided vendors who fail to collect the tax due to the insolvency of their customers.[1]

All persons who as a regular part of their business in Ontario make sales to consumers in Ontario are required to collect the tax. This requirement extends to such persons as manufacturers and wholesalers who may only rarely make sales to consumers. Persons who are not in the business of selling goods but who make casual sales are not required to collect the tax and in such cases the responsibility for payment of tax rests with the purchaser. Since there is no administrative machinery set up to police such transactions (except in the case of automobiles which must be registered with the provincial government) collection of tax on casual transactions is very uncertain even though the purchaser's liability may be very clear under the Act.[2]

The regulations require that in all cases where a liability for tax has arisen which has not been satisfied through the normal procedure of collection by a vendor (e.g. imports), the person liable for the tax must remit the tax payable on or before the 23rd day of the month following that in which the liability for tax arose.

Vendors

Vendors who are required to act as agents of the Crown are required to obtain a permit for each place in Ontario where business is transacted. Vendors who have not obtained permits are prohibited from selling tangible personal property either to consumers or to any other persons. Consequently, all persons who in the ordinary course of their business in Ontario sell tangible personal

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1. See also page 38
2. See also page 32

property to a purchaser in Ontario are required to obtain a permit. Permits are used not only for the purpose of controlling the collection of tax but also to control the exemption of sales from one person to another where the goods are purchased for resale or incorporation into other goods for sale. Thus, persons not registered as vendors are prohibited from purchasing any conditionally exempt goods without payment of tax.

Vendors collecting tax on behalf of the Crown must clearly indicate the tax on their sales invoice and must not sell at a tax-included price.

Provision is made in Regulation 6 for the issuance of special permits known as "G" permits. The holder of a "G" permit is authorized to purchase all goods free of tax without the issuance of the normal purchase exemption certificates. Accordingly, he is not required to certify that the goods are for resale or are otherwise exempt under the provisions of the Act. "G" permits are issued only to larger corporations whose sales to consumers exceed $2,000,000 per annum, whose accounts are audited annually by a recognized firm of public accountants, and whose credit rating is, in the opinion of the Comptroller, sound.

Registered consumer

In order to control to some extent the payment of tax by purchasers who are not registered vendors, all persons who import into the Province goods having a fair value exceeding $100 in each of two months or more during a calendar year must be registered with the Comptroller as a registered consumer. Registered consumers are required to file returns and pay any tax owing on or before the 23rd day of the month following that in which the liability for tax arose.

Non-registered vendors

Regulation 9 provides for the issuance of special certificates to persons who do not hold a vendors permit but who solicit orders in Ontario for goods to be shipped from outside of Ontario. The regulations provide that the special certificates must be carried at all times when the holder is soliciting orders and must be produced upon the request of a purchaser or any duly authorized representative of the Comptroller. No penalties are provided for failure to obtain a special certificate however, and there is no requirement for purchasers to refuse to order from persons who do not hold a certificate. Furthermore, the regulation requiring persons to obtain certificates applies only to persons who are physically present in Ontario when soliciting orders and does not apply to persons soliciting orders by direct mail or to persons accepting orders outside of Ontario.

Persons who hold special certificates are required to submit a monthly return setting out details of orders for tangible personal property accepted and the date on which the property is to be delivered to the purchaser. The intention of the regulation is to enable the sales tax authorities to make sure that the purchase is properly reported by the purchaser and that the proper tax is remitted.

Taxable goods produced for own use

Where a manufacturer produces goods for his own consumption or use, tax will apply to the cost of these goods, including labour, materials, manufacturing overhead and federal sales tax.[1]

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1. It might be noted that the Ontario rulings making reference to the federal sales tax refer to it as being imposed pursuant to section 31 of the Excise Tax Act (Canada). This reference should probably be removed since section 31 is not a charging section.

Repairs, reconditioning and remanufacturing

Repairs fall into three general categories for Ontario sales tax purposes. The repair of motor vehicles and appliances is considered the sale of tangible personal property and tax must be collected by the vendor making the repair. If the charge for materials is segregated from the labour charge, only the material charge is subject to tax, otherwise the full charge to the customer is taxable.

The repair of jewellery, watches, clocks, luggage, etc. is considered to be a sale of services only and is not taxable. The person making the repairs is considered to be the consumer of all materials used in his repair work and accordingly, such materials are taxable at the time he acquires them. If he also sells similar parts he may purchase the goods exempt and account for tax on the basis of their cost at the time he uses them.

The repair of furniture, furs and fur garments, and upholstery may be taxable depending on the extent of the value of materials going into the repair. On all repairs where the value of materials is less than 20% of the total charge for repairs the repair is not taxable and the person performing the repair is considered the consumer of all taxable materials which he uses in his repair operation On all repairs where the value of materials is 20% or more of the total repair charge the sale is taxable. If the charge for materials is segregated from the charge for labour, only the material charge is taxable, otherwise the total charge is subject to tax.

Repairs to tax exempt property or to goods for resale by a registered vendor are in all cases exempt from tax.

The sale of rebuilt engines and the repair or reconditioning of goods such as retreaded tires where the customer does not necessarily receive back his original goods is taxable on the total charge.

Rentals and hire-purchase contracts

In the case of a hire-purchase contract (or similar arrangement that is designated as a lease in order to retain title to the property in the vendor as security for payment) the transaction is considered a sale on credit and as such tax applies on the total purchase price at the time the arrangement is entered into. Where taxable tangible personal property is rented or leased under a contract which does not grant the lessee an option to purchase, tax applies on the rental payments. In order to attempt to eliminate the service and interest factor from rental payments tax is based on 90% of the rental payments if the rental period is more than six days and not more than one month and on 80% of the rental payments where the rental period is in excess of one month.[1] Where taxable tangible personal property is leased under a lease option arrangement, tax is payable on the rental payments on the above basis. Should the option to purchase be exercised tax is also payable on the option price.

Where tangible personal property is acquired by a purchaser for rental purposes the transaction is not deemed to be a sale to him for his consumption or use and therefore is not taxable. In the case of casual rentals of tangible personal property acquired for consumption or use tax is payable by the lessee on the rental charges and no relief is granted for the tax previously paid by the owner of the property.

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1. See also page 37

Property temporarily brought into Ontario

Where tangible personal property is temporarily brought into Ontario for consumption or use tax may be applied on the basis of the fair rental value of the tangible personal property. The basis generally used to determine a fair rental value is one-sixtieth of the original cost of the property for each month the property remains in the Province.

Settlers' effects

Persons ordinarily resident outside the Province of Ontario may bring into the Province, without the payment of tax, all household goods and equipment owned prior to taking up residence in the Province.

Exemptions from tax

Exemptions from the Ontario sales tax are provided for a wide variety of goods. A detailed list of these exempt goods is set out in Appendix B attached. The more important exemptions fall into the following general categories:

1. Food
2. Gasoline, electricity and other fuels
3. Farmers' and fishermen's implements and supplies
4. Water, clay, sand, gravel and unfinished stone
5. Drugs and medical appliances
6. Producers' goods
7. Equipment of railways, airlines and steamship companies
8. Children's clothing
9. Printed matter and educational supplies
10. Sales for delivery outside the province
11. Purchases costing less than 21¢

Food -

Food products for human consumption off the premises of the vendor are exempt from tax. This exemption does not extend however to candy, confections or soft drinks. Prepared meals consumed on the premises when sold at a price of $1.50 or less are also exempt from tax. Prepared meals costing in excess of $1.50 are taxable unless consumed in places of entertainment and subject to the 10% tax under The Hospitals Tax Act or unless specifically prepared for consumption off the premises or delivered to a person's home.[1]

Where a meal is catered however the entire charge for the catering service is taxable.[1]

Alcoholic beverages consumed with a meal are subject to tax, separate from the charge for the meal, unless consumed in places of entertainment and subject to the 10% tax under The Hospitals Tax Act.

Where meals and lodging are provided for a single charge an allocation of the charge must be made to determine if the meals are taxable. The allocation is made on the basis of a formula set out in Ruling 13.

Gasoline, electricity and other fuels -

Gasoline for use in internal combustion engines and motor vehicle fuels are exempt from tax. This exemption is extended even though the products are exempt because of their use from tax under either The Gasoline Tax Act or The Motor Vehicle Fuel Tax Act. Coal, coke and electricity are exempt from tax regardless of the use to which they are put. Wood is exempt from tax if intended to be used as a fuel. Natural gas and manufactured gas are exempt if intended to be used as a fuel for lighting, heating or cooking purposes.

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1. See also page 41

Farmers' and fishermen's implements and supplies -

Most farmers' and fishermen's implements and supplies are exempt from tax. In some cases the exemption applies regardless of the status of the purchaser due to the restricted use of the particular goods. In other cases, where the goods could be used for other than farming or fishing, the exemption only applies if the purchaser can certify that he is a bona fide farmer or fisherman

Drugs and medical appliances -

Drugs and medicines sold under prescription and various orthopaedic, dental and optical appliances are exempt from tax. Equipment purchased by hospitals and sanatoria and used directly in patient care is generally exempt.[1]

Producers' goods -

Tangible personal property purchased for the purpose of being processed, fabricated or manufactured into, attached to, or incorporated into tangible personal property for sale is exempt from tax. Tangible personal property purchased for incorporation into real property is taxable.

Special rules are provided for returnable and non-returnable containers. Returnable containers are considered to be used by the person who ships goods in them and consequently, tax is exigible at the time such a person purchases the containers. Tax is not charged on the container when it is transferred to a customer in connection with the retail sale of its contents Non-returnable containers and other packaging materials are considered to form part of the goods contained in them. Accordingly, they may be purchased free from tax except when purchased by persons who are not vendors, e.g. dry cleaning establishments, etc.

Materials consumed or expended directly in the process of manufacture or production of tangible personal property for sale are also exempt. This exemption follows exactly the federal exemption for consumable materials. Machinery and apparatus to be used directly in the process of manufacture of tangible personal property for sale is also exempt from the Ontario sales tax. In the past the Province has followed exactly the federal exemption for such machinery. While this exemption was withdrawn for federal purposes on June 13, 1963 the Province intends to continue its exemption. Since these goods will be subject to lower than normal rates of tax for federal purposes up to December 31, 1964 the Province can continue to tie its exemption to the federal rulings up to that date. If the exemption for production machinery is to be continued by the Province after December 31, 1964 it will be necessary that the Province provide its own rulings on the exemption of such goods after that date.[2]

Equipment of railways, airlines and steamship companies -

Goods exempt under this general category include aircraft normally engaged in foreign or interprovincial trade, road cleaning and fire fighting vehicles costing more than $1,000 per vehicle, vessels of more than 500 tons gross and railway rolling stock including street cars, subway cars and electric railway rolling stock. Buses (other than school buses) used to provide public transportation within a municipality are also exempt.[2]

1.See also page 41
2.See also page 39

Children's clothing -

Various children's clothing and footwear are exempt from tax. The exemption is entirely determined by the size of the clothing and no reference is made to the age of the child.[1]

Printed matter and educational supplies -

Books of an educational, technical, cultural or literary purpose, newspapers, religious publications and equipment purchased by religious institutions, student supplies, and classroom supplies purchased for use by schools and universities are all exempt under this general category.[2]

Sales for delivery outside the Province -

Tax does not apply to the sale of goods that are shipped to a point outside Ontario by a vendor. If the sale is made to a non-resident and delivery of the goods is taken in Ontario the sale is taxable. Where goods are purchased at a retail sale in Ontario and the tax is paid, the Province will entertain a claim for refund if the goods are within thirty days from the date of purchase shipped outside the Province for consumption or use.

Tangible personal property entering into capital works projects -

Property used in the construction of hospitals, nurses' residences, schools, universities and municipal capital works may be purchased free of tax.[3]

Purchase exemption certificates

Purchase exemption certificates must be supplied in order for a registered vendor to acquire conditionally exempt goods without payment of tax. This applies to such goods as producers' goods where the end use of the product determines the taxable status of the goods. In addition registered vendors acquiring tangible personal property for resale must also provide their supplier with a purchase exemption certificate. Exemption certificates may be issued with each purchase order or blanket certificates may be used. All certificates must indicate the vendor's permit number, describe generally the type of goods being purchased and must be signed by the purchaser. Where blanket exemption certificates have been provided, all future orders must make reference to that fact if tax exemption is requested.

As noted earlier, holders of "G" permits are not required to supply purchase exemption certificates, the mere quoting of their licence number being sufficient authorization to the vendor for the granting of exemption.

Transfers of merchandise between related persons

Provision is made under Regulation 19 to exempt from tax transfers of tangible personal property between certain related persons. To be exempt the goods must have been purchased by the transferor either tax-paid or purchased prior to August 31, 1961. For the purposes of this regulation related persons include parent and subsidiary corporations (95% owned) but the exemption does not extend to transfers between a parent corporation and a sub subsidiary corporation. The regulation permits the Comptroller to allow the parent-subsidiary exemption on transfers between other corporations where in his opinion the permitting of the exemption is not inconsistent with the intention of the section.[4]

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1. See also page 42
2. See also page 42
3. See also page 44
4. See also page 50

No tax is exigible on tangible personal property transferred to a corporation at the time of its incorporation either for shares of the corporation, or, for other consideration if the purchasing corporation is owned and controlled by the person, partnership or corporation making the sale. In all other cases of transfers of tangible personal property between related persons tax is exigible.

Gifts

The transfer of tangible personal property between members of a family for no consideration by gift or otherwise is specifically exempt from tax. This exemption extends only to property acquired from lineal ancestors and descendents. The exemption does not extend to persons acquiring property from their brothers, sisters or other collateral relatives.[1]

Real property construction contracts

Persons who enter into contracts for the construction of real property are regarded as consumers or users of the tangible personal property incorporated into the real property being constructed. Consequently, such persons are required to pay tax at the time of purchase of tangible personal property for use in the construction contract. No tax is payable on the contract price itself as real property is not subjected to tax under the Act.

Contractors are defined by Regulation 1 - 18 as "persons who engage in the business of constructing, altering, repairing or improving real property for others . . who instal on or incorporate into real property, tangible personal property for a person other than themselves, but when a contractor manufactures tangible personal property for sale and acts as a manufacturer as defined in this Regulation he shall be regarded, while he is engaged in the manufacture of such tangible personal property as a manufacturer and not as a contractor". Manufacturing contractors are defined by Regulation 1 - 33 as "a manufacturer who fabricates or manufactures tangible personal property for his own consumption or use in the performance of construction contracts".

Contractors who do not manufacture tangible personal property to be used in construction contracts are not required to obtain a vendor's permit. All purchases are made tax-paid and the tax content of any purchase of tangible personal property forms part of the cost.

Manufacturing contractors are required to purchase material which will be manufactured as a tangible personal property for the use in the construction contract tax-exempt by quoting their vendor's permit. Where goods manufactured by the manufacturing contractor are used by him in the performance of the construction contract he is required to account for tax on the value of the manufactured property including the cost of the materials, the labour, all factory overhead costs and any tax payable under the Excise Tax Act.

In some cases contractors in addition to acting as contractors also operate retail outlets. This is particularly true in the case of electrical, plumbing, heating, sheet metal, tile and other similar fields. In such cases the contractor is required to obtain a vendor's permit in connection with his retail operations. Where goods purchased exempt from tax under the permit are used in connection with a construction contract the contractor is required to account for tax based upon the cost price of such materials.

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1. See page 44

Under the provision of Ruling 3, ready-mix concrete operators and hot and cold asphalt mixers are not regarded as manufacturers of the product (i.e. plastic concrete or plastic hot or cold asphalt mixes) which they supply to construction contractors. They are regarded rather as contractors and are required to pay tax upon their purchases. This variation from the general rule regarding manufacturing contractors was instituted in order to avoid the unfair competitive problems faced by a ready-mixed concrete or asphalt supplier a large part of whose costs consists of sand and gravel which is exempt under the Act. If such persons were regarded as manufacturers of the concrete they would be required to collect tax from their customers based upon the selling price of the concrete including the costs of sand and gravel. Contractors who mix their own concrete on site would not be required to account for tax in respect of the sand and gravel used in the concrete and hence an unfair competitive disadvantage would be placed upon ready mix suppliers if they were regarded as manufacturing contractors. The same arguments hold true in the case of asphalt mixes.

In 1964 the Retail Sales Tax Act was amended to provide special rules in the case of "non-resident contractors". Non-resident contractors are defined by paragraph 37(a) of Regulation 1 as "a contractor, whether an individual or a corporation, who has not maintained in Ontario continuously for a period of twelve months immediately preceding the date of the signing of any particular contracts a permanent establishment as defined in subsections 1 to 7 of section 2 of the Corporations Tax Act in respect of corporations". Where such a contractor enters into a contract with any person under which tangible personal property will be consumed or used in Ontario, the non-resident contractor must deposit with the Treasurer a sum equivalent to 3% of the total contract price or supply the Treasurer with a satisfactory bond in the same sum. The contractor must then obtain from the Treasurer a certificate that these requirements have been met.

Persons dealing with non-resident contractors must ensure before the contract is signed that the non-resident contractor has met the requirements. Failure to do so places upon the contractee an obligation to deduct 3% of all amounts payable to the non-resident contractor and pay it over to the Treasurer on behalf of the non-resident contractor, or alternatively to furnish a bond with the Treasurer equal to 3% of the total contract price. Where the person dealing with the non-resident contractor fails to ascertain that the non-resident contractor has obtained a suitable certificate from the Treasurer and also fails to withhold tax or post a bond he may be liable for any taxes payable under the Act which are not paid by the non-resident contractor.[1]

Returns

Monthly returns are required from all registered vendors indicating the total sales of tangible personal property made during the month. In addition vendors must report the amount of all purchases made by them on which tax was not collected by the supplier and on which tax is exigible. This provision applies to all holders of vendors permits including holders of "G" permits. A similar return of taxable purchases is required from all registered consumers. These returns are due on or before the 23rd day of the month following the month in which the liability for tax arose.

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1. See also page 54

Provision is made to vary these reporting requirements in the case of vendors carrying on a highly seasonal operation or who maintain their accounts on a four or five week basis rather than a monthly basis.

In addition to the monthly returns required from registered vendors and registered consumers, all persons importing goods into the province for their own consumption or use must make a similar return reporting these purchases.

Persons soliciting orders in Ontario for goods to be shipped into the Province from a point outside the Province who are not registered vendors must obtain a special certificate authorizing them to solicit orders in the Province. Persons holding these certificates are also required to make monthly returns detailing all orders taken during the month and indicating the name and address of the purchaser, a description of the property, the date of the order and the approximate delivery date.

Records

The Act requires every manufacturer, wholesaler, importer, jobber, agent and vendor to keep records of all purchases and sales of tangible personal property whether for consumption or use or for resale. Regulation 13 sets out in more detail the records to be kept by vendors. Since most of the classes of persons mentioned in the Act will be vendors as defined in the Act, this regulation will apply to almost all businesses other than those in the service industries.

The specific records include details of -

(a) all inventories of tangible personal property,
(b) purchases of tangible personal property,
(c) sales of tangible personal property,
(d) tangible personal property purchased or taken from stock by the vendor for his personal consumption or use or that of his business or supplied to his employees where the use of any such property has not been recorded as a retail sale,
(e) discounts and refunds,
(f) the amount of tax collected,
(g) disposal of tax including the remuneration taken.

Rebate of tax

Provision is made for rebates of tax incurred on capital works projects of religious, charitable and benevolent organizations. The rebate is made directly to the organization and is made on the basis of 1.25% of the total contract price.

Remuneration to vendors

Remuneration is granted to registered vendors in return for their collecting tax on behalf of the Crown and may be deducted by the vendor from his monthly remittance of tax. The amount of remuneration varies depending on the dollar amount of the average unit sale and the amount of tax collected. No remuneration is granted in respect of tax owing on taxable tangible personal property on which tax was not paid at the time of purchase. The remuneration may be denied to any vendor who is tardy in filing returns.[1]

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1. See also page 54

Assessments

The Comptroller of Revenue for the Province may at any time he considers reasonable, assess or reassess tax collected or collectible by a vendor or payable by a purchaser. Evidence of the assessment must be supplied to the vendor or purchaser by registered mail.[1]

The Comptroller has full powers to examine all records of the taxpayer or any other person with which the taxpayer is dealing in order to establish the proper amount of tax which should have been collected or paid.

Objections to assessments

Any vendor or purchaser who wishes to object to an assessment must do so within 30 days of the day of mailing the assessment. A notice of objection must be filed with the Comptroller in duplicate by registered mail.[2]

Appeals

Where, after filing notice of objection, an assessment is confirmed or a reassessment issued a taxpayer may file notice of appeal within 90 days of the date the original assessment was confirmed or a reassessment issued. Notices of appeal must be filed in duplicate with the Comptroller and a copy provided to the Registrar of the Supreme Court of Ontario. As security for costs the taxpayer must pay into court any amount requested by the Treasurer of Ontario up to $400.[3]

Interest and penalties

Various penalties are provided for failure to comply with the provisions of the Act. A penalty of 5% of the tax collected (maximum $500) is provided in the case of default in filing returns by registered vendors. Unpaid or unremitted tax bears interest at 6% per annum and if an assessment has been issued the interest rate increases to 9% if the tax is not paid within 30 days of the date of assessment.

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1. See also page 54
2. See also page 55
3. See also page 55

ANALYSIS OF THE ONTARIO RETAIL SALES TAX

Paragraph (b) of the terms of reference requires an analysis of the Ontario Retail Sales Tax Act, Regulations, Rulings and administrative practices as regards to simplicity, clarity and efficiency, and an examination of the presence and effects of anomalies and inequities therein.

Earlier in this study, certain general principles of taxation against which the Ontario retail sales tax might be measured were set out. These principles were certainty, simplicity, effectiveness, convenience, neutrality and economy of collection. The Ontario Retail Sales Tax Act together with the Regulations and Rulings measures up to these principles quite well. There are, however, a number of areas in which the tax might be improved.

Basis of the tax

In its present form the Ontario retail sales tax is not a retail sales tax at all but rather a tax on the consumption of goods. In the case of retail sales, the retailer must report taxable sales and collect the appropriate tax on behalf of the province. The Retail Sales Tax Act also requires that purchasers acquiring goods at a transaction other than a retail sale must report their purchases to the Treasurer and pay the tax thereon. This provision is completely ineffective since there is no machinery for policing such a requirement. The one outstanding exception to this rule is in the case of an automobile which must be registered with the Provincial government. The government can therefore control the collection of tax on each transfer of title to the automobile.

There is one interesting exception to the rule that tax is paid on the full value by each purchaser. This is in the case of goods which are traded in at the time of purchase of other goods of the same general character and kind. In such cases tax is payable at the time the goods are purchased only on the difference between the value of the goods purchased and the value of the goods traded in. Thus, so long as goods consistently go back to a trader or dealer in such articles, there is no compounding of the tax. The automobile provides a good example. If the automobile in the initial instance costs $4,000 and after a year is traded in on another automobile for $3,000 the initial purchaser in effect gets a refund of the tax on the $3,000 value at the time of trade-in. The subsequent purchaser of the automobile traded in pays tax on his purchase price but again when he trades it in he too obtains a refund of the tax he has paid to the extent that the article still has value. It should be noted that this system works only so long as the person trading in the article is purchasing another article of the same type from a dealer. Thus, an individual who sells a car to a used car dealer and does not purchase another vehicle at that time does not get any refund of the excess tax.

There are theoretical grounds for criticising a tax on consumption that is measured by purchase cost. As a measure of the consumption or use made of the article, the purchase price is in many cases a poor indicator. Again looking at the automobile, a person who has purchased an automobile for $4,000 and now sells it after one year for $3,000 has really obtained $1,000 worth of use out of the automobile and this is the amount on which he should be required to pay tax. Having sold the automobile for $3,000 he has this money

to use in some other way. Thus, the initial cost is not the proper measure of use. The diminution in value of the article during the period in which it is used by the purchaser should however be a proper value for determining tax.

In the case of absolute consumables such as food there is of course no value after the initial use. In the case of clothing there is generally little additional use but sometimes there can be additional use and clothes can be traded in on other clothing, (e.g. clothing exchange shops) or can be given away to friends or relatives. There are, however, a number of durable type goods, including furniture, automobiles, boats, etc. which do have a substantial value and which may not be completely used by the first purchaser. In such cases the use of purchase price as the basis for charging tax rather than the diminution in value during the period of use can result in an excessive amount of tax being levied on the consumption or use of such goods.

Where goods are traded in on other similar goods tax is in effect collected only on the actual value of the use obtained by the person trading in the article. The deduction of trade-in allowances in determining taxable value is justified on these grounds. Presuming this to be a proper basis for the determination of taxable value, can there be any logical reason for taxing such an article when it is sold privately rather than being traded in? In other words, if the theory of the tax is that tax should be paid on all articles based upon their initial value to the purchaser no trade-in allowances should be granted. Where, however, it is assumed that the deduction of trade-in allowances is justified, there is surely no justification for taxing any article a second time when it is transferred at a casual sale.

When tax is calculated at the rate of 3%, the duplication of tax is relatively unimportant. It may be argued in the case of objects of art, stamp collections, etc. which do not decrease in value over a period of time that the duplication of tax will be serious at any rate of tax. However, for most goods which wear out and lose value over a period of time, the duplication is unlikely to be significant except in unusual circumstances.

The provincial tax rates however may increase over a number of years in order to meet the growing demands of the provincial government for revenues. As the tax rates increase the inequity in taxing durable goods more than once becomes more serious. Persons purchasing tangible personal property at a casual sale are already reluctant to report such purchases and pay the tax on them. The difficulties in forcing such persons to report casual purchases are very great indeed and we believe that this type of requirement is unenforceable.

The leakage that now exists through inadequate administration and enforcement of the rules as they stand is probably relatively unimportant from a revenue point of view when the rate of tax is only 3%. However, the ability of casual purchasers to escape the tax breeds disrespect for the law. As the tax rate increases, the revenue loss will become more serious and at the same time disrespect and attempts to evade the tax will grow. The very fact that the provisions of the Act relating to casual sales are unenforceable represents a very serious criticism of this type of tax and is one of the strongest arguments for moving from a consumption tax to a true retail sales tax.

It should be noted that a tax on the consumption of goods gives rise to difficulties in the case of gifts of tangible personal property. While the Ontario Act exempts transfers for no consideration amongst members of a family

(lineal ancestors and descendants only) there is no procedure under which the reporting of other gifts can be enforced. Consequently, while the law requires reporting of such items it would be the exception rather than the rule where such transfers were reported. This type of difficulty would also be solved by a change in the tax to a true retail sales tax since transfers by way of gifts would not be taxable.

Under a retail sales tax system it is necessary to determine whether tax will apply to all sales of tangible personal property made by vendors or whether tax will apply only where a vendor sells new goods. Good arguments may be made for both systems although in practice most jurisdictions impose tax on all sales by vendors. The Province of Saskatchewan is a notable exception to this rule. In Saskatchewan only the initial sale or importation of an article gives rise to tax and subsequent transfers either at retail sales or at casual sales are exempt.

If all retail sales are taxable it is necessary to provide rules similar to Ontario's present trade-in provisions so that purchases are taxed only on the net price paid. In this way most duplication of tax is avoided. There is a problem where an individual sells goods to a vendor for cash and does not purchase any goods in exchange. Since the dealer must collect tax on his selling price, he must purchase all goods exempt from tax and it is therefore not possible to make any allowance to individuals from whom he purchases goods for resale in respect of the tax content of the used article. At the same time difficulties may arise in the case of barter or exchange transactions where tax has not previously been paid on the goods given to the vendor in exchange for taxable articles. Special rules would have to be applied to ensure that tax was properly paid in such situations.

If on the other hand it is decided that tax will only apply where a vendor sells new goods the difficulties inherent in trade-in allowances will disappear. In its place a new problem arises since it is necessary for the vendor to distinguish between non-taxable used goods and taxable new goods. While it would perhaps not place a very great strain on vendors to make such a distinction (since only a few vendors sell both new and used goods) there might be some administrative difficulties through tax evasion on the part of vendors classifying new goods as used to escape the tax. Such deceptions can however be uncovered through relatively simple audit techniques.

In our view, the latter system (applying the tax only to sales of new goods) has a slight advantage over a system which imposes tax on all retail sales. We do not believe, however, that serious problems would arise under either method.

In the preceding paragraphs we have recommended that the Ontario Retail Sales Tax Act should be changed from a tax on all consumption or use of tangible personal property to a true retail sales tax. The Canadian provinces are, however, restricted to levying direct taxes only. Consequently, it would appear that the courts would rule a true retail sales tax (i.e. a tax levied on the retailer in respect of his retail sales) to be invalid since this would be a form of indirect taxation. It is for this reason that the provinces have adopted the consumer or user type of tax. The Province of Saskatchewan, however, levies a tax similar to a retail sales tax. It has managed to keep its tax within the constitutional framework by imposing tax upon the consumer or user

of goods purchased at a retail sale and providing an exemption from tax for goods which have previously borne the Saskatchewan tax. There was initially some doubt as to whether this form of tax could be considered to be a direct tax but any doubts on this score were laid to rest by the Supreme Court in its June 13, 1960 decision in the case of Cairns Construction Limited v. the Government of Saskatchewan. The court held that the Saskatchewan Education and Hospitalization Act (now the Education and Health Act) imposed a direct tax and was therefore intra vires of the Saskatchewan Legislature.

We would not recommend, however, that the Province of Ontario follow the same form as the Province of Saskatchewan in providing specific exemption for goods on which tax has previously been paid. This type of provision could create a difficulty in that a vendor might technically be required to show that tax had in fact been paid on any article before he could sell it without charging tax on it. In the case of an act such as the Ontario Retail Sales Tax Act which has been in force only since September 1, 1961, it would be difficult for any vendor to show whether or not tax had in fact been paid on an article unless the date of its original sale could be clearly demonstrated. Accordingly, it seems preferable that the charging section of the Act should levy tax only in the case of a retail sale of new goods. New goods for this purpose would be defined to include any tangible personal property which had not been previously transferred at a retail sale.

Services

At the present time the Ontario Retail Sales Tax Act charges tax only on the consumption of tangible personal property. By definition, telephone service is considered to be tangible personal property and therefore telephone charges (other than long distance telephone charges) are subject to tax. However, no other types of services are specifically taxed under the Act.

In recent years the service industry has accounted for an increasing percentage of the gross-national product. With the necessity for increased revenues becoming urgent and the general pressure for the reduction of other types of taxes, attention is naturally being focused on the service industry as a source of additional tax revenue.

There are many arguments in the favour of a sales tax on services. A sales tax is imposed on the assumption that a taxpayer's ability to pay can be measured by reference to his expenditures on consumption. Consumer expenditures may be made for either goods or services, and it seems somewhat artificial to levy tax on the basis of consumption of goods and ignore the consumption of services. In many cases it is difficult to distinguish between a charge made for goods and a charge made for services. For example, a manufacturer may sell his product at a rate that includes installation of the product on the customer's premises. In the case of the Ontario Retail Sales Tax Act the definition of "fair value" includes the cost of installation where the contract under which the property is acquired provides for the acquisition of the property and its installation for one consideration. However, where the vendor makes a separate charge for installation the installation charge is exempt. In many cases it is difficult to determine the portion of the price which should be allocated to the installation especially where the manufacturer only sells goods on an installed basis. The same general situation holds true in the case of goods sold under warranty, where the vendor contracts to keep the property which is

being sold in good repair over a period of time without making any charge .

As the level at which sales tax is levied comes closer to the point of consumption, the arguments in favour of a tax on services become stronger. Since the distribution of goods to consumers is essentially a service function and the charges for distribution services are included in the price of the article on which tax is paid, the costs and profits of the distribution industry are in effect subject to sales tax. If other services are not taxed, the sales tax discriminates not only between goods and services, but between one service industry and another.

When the tax on goods is levied at the retail level the arguments in favour of a tax on services are very strong. Many retail merchants deal in both goods and services (e.g. garages, appliance dealers, repair shops, etc.) and it is frequently difficult to distinguish between the charge made for goods and the charge made for services. Strong arguments may be made that a retail sales tax which is imposed on tangible personal property only, discriminates in favour of expenditures on services. In view of the strong equitable argument in favour of taxing services and the substantial revenues which could be obtained from such a tax it is somewhat surprising that none of the Canadian provinces has attempted to levy a tax in this area.

One of the reasons for the reluctance of the provinces to tax services has undoubtedly been the administrative difficulties involved in such a tax. We believe that these difficulties have been overstated in the past and that in spite of the large number of service enterprises that would have to be licensed and administered by the sales tax authorities a sales tax on services is both feasible and desirable.

There are two ways in which a tax on services may be imposed. Tax may be applied generally to all services in the same way that tax applies generally to all goods. Alternatively, tax may be applied only to specific services that it is desired to tax. For reasons of administrative efficiency, the second form of taxation is generally thought to be preferable. If tax is levied on all services an inevitable administrative problem arises in dealing with a large number of small service entrepreneurs. In addition, serious conflicts arise as between the taxation of services which can be rendered either by a service organization or by an employee. For example, housecleaning can be performed either by a service organization or by a domestic servant. In some cases housecleaning services are performed by one individual for a number of customers. It would be unrealistic to attempt to collect tax on the services rendered by such a person. Similar difficulties arise in the case of a number of other types of service enterprises.

In addition, services rendered to business organizations should be exempt from tax. This exemption would be necessary in order to avoid the pyramiding of the tax. Materials used by manufacturers are exempt for the same reasons.

For these reasons it is generally thought prefereable to levy tax only on those services which do not provide administrative difficulties and which are normally performed for individuals. We list below a number of services which might be taxed:

1. Repairs and reconditioning (except goods exempted from tax as producers goods and repairs made without charge under warranty or as part of a normal service granted by a manufacturer or vendor to a customer);

2. Laundry and dry cleaning services;
3. Garage services;
4. Barber and beauty salon services;
5. Hotel and motel charges;
6. Storage charges;
7. Charges for installation of tangible personal property in real property.

This is by no means a complete or exhaustive list of the types of services which might be made subject to tax. Many other examples may be found of services which should be taxed and which would not create substantial administrative problems.

Rental contracts

Under the Ontario Retail Sales Tax Act rentals are considered to be sales and sales tax is therefore exigible on rental payments. In our opinion tax on rental payments offends against the rule that sales tax should be neutral in its effect since it imposes an additional tax on consumers who acquire property by lease rather than by purchase. This is particularly true in any case where services are not made subject to tax.

The problem in connection with rental payments arises because a rental charge is a combination of a number of factors. Rental charges include a charge in respect of the consumption or use of the leased article and also a charge in respect of the financing cost borne by the lessor. In addition, the lessor frequently renders service in the maintenance of the leased asset and this service is of course included in the rental payments.

The taxation of leased property may be contrasted with the taxation of property purchased under a conditional sales agreement or subject to a chattel mortgage. In the case of leased property, tax applies not only to the fair value of the asset at the time it is leased but also to the charges for financing,and if services are rendered,to the service charges as well. In the case of property which is purchased,however, financing charges are not made subject to tax. If service contracts are entered into, these too would be exempt from tax unless the tax is extended to apply to services.

The Province of Ontario has recognized this problem and has attempted to make allowance for the financing and service charges through taxing only a portion of the rental payments where the rental contract is for more than a few days. Where the rental is for a period of six days or less, tax is charged on 100% of the rent. Where the rental period exceeds six days but is less than a month, tax may be charged on the basis of 90% of the rent and where the rental period is longer than one month the tax is calculated on the basis of 80% of the rental charge. There is no provision for taxing rentals on any more favourable basis than 80% of the rental charge. Accordingly, a lease for ten years is taxed on the same basis as a lease for one month and one day. It is clear that while Ontario has attempted to recognize the inequity of taxing rentals in full, the formula which is used to determine the appropriate portion of the rental payment on which tax should apply is absurd.

We believe that the current provisions of the Ontario Retail Sales Tax Act relating to rental payments are inequitable. In the case where the lessor renders services to the lessee in connection with the repair and

and upkeep of the leased property no appropriate formula can be found which will suit all cases. The portion of the rental payment relating to services will vary widely, according to the type of product which is leased. Consequently, any effort to establish an average service factor calculated as a percentage of the gross rental is bound to be overly generous to some lessors and work a hardship on others. It should be noted that this problem disappears if services are made subject to tax. If, however, services are not made subject to tax, then it appears more appropriate to us to tax the lessor as the consumer or user of the article and to exempt rental payments from the sales or consumption tax. If this were done, the service and financing elements in rental charges would in effect be exempted from tax and only the consumption or use portion of the rental payments would be subject to tax.

If, on the other hand, services are made subject to tax then rental payments should also be subject to tax. In this event, equity may be achieved by making an appropriate allowance in respect of the financing of the asset. We would recommend that allowances for financing be made on the basis of an interest rate of 6% to 8% per annum and that discounts be granted only in cases where the rental period is more than one month. Discounts calculated at an 8% interest rate might be as follows:

Leases up to one year, 4%;
Leases over one year but less than two years, 8%;
Leases over two years but less than three years, 12%;
Leases over three years but less than four years, 17%;
Leases over four years but less than five years, 22%;
Leases over five years, 30%.

Vendors' bad debts

At present, no relief is provided for vendors who fail to collect tax because of the insolvency of their customers. The question of relief to vendors may be looked at in two ways. Under the first way, the vendor should collect the tax at the time of sale and delivery of the goods. By granting credit terms to his customer, he is simply advancing funds over and above the sale price of the taxable property. This is a free choice on the part of the vendor. If he fails to collect the tax and sale price from his customer, the loss is a direct result of his advancing credit. When looked at in this way, there appears to be no good reason for providing any relief where a vendor fails to collect the tax because of the insolvency of his customers.

The other way of looking at this problem is to take the position that sales on credit are an ordinary and necessary business practice, hence it is unreasonable to expect that tax must be collected on a C.O.D. basis. Under this approach it seems reasonable to expect the vendor to be responsible only for the tax which he is able to collect from his customer.

We believe that as a matter of principle, vendors should not be required to remit tax when they are unable to collect it from their customers, either because of insolvency or for any other valid reason. On the other hand, at present rates of tax, the point is not of great significance.

Exemptions

Generally speaking, exemptions in a sales tax system are undesirable since:

(a) They create administrative difficulties for vendors and tax authorities alike;

(b) They tend to destroy the neutrality of the tax, and

(c) They erode the tax base and thus reduce the revenue.

Where tax is levied at a modest rate the neutrality of the tax is not seriously affected, but exemptions create administrative difficulties and erode the tax base no matter what rate of tax is charged. The problems resulting from exemptions increase as the number of exemptions increases and for this reason it is preferable to limit exemptions as much as possible.

Not all exemptions should be considered objectionable. Administrative difficulties do not arise in the case of an absolute exemption granted to specific purchasers who can be identified by special licence numbers and certificates. For example the complete exemption from tax on purchases granted to holders of "G" permits does not create any administrative problem for vendors making sales to such persons. Difficulties do arise however where exemptions are conditional upon the use to which property is put or where exemption is granted for certain specific types of goods or sizes of goods. Similarly exemption of some classes of goods cannot be considered to be an erosion of the tax base if taxation of the goods would give rise to pyramiding of the tax.

There are two basic reasons for granting exemptions. The first of these is to avoid pyramiding of the tax. Exemptions for producers' goods fall into this category. The second is the social objective to eliminate the regressive features of a sales tax and to create a preference for socially desirable objects. Depending on the way in which exemption is granted administrative problems may arise in connection with exemptions in the first category. Neutrality and erosion of the tax base are not however factors in determining the acceptability of such exemptions. Exemptions falling in the second category however give rise to all of the types of difficulty outlined above and it is this type of exemption which is most undesirable from the point of view of an efficient taxing system.

Producers' goods -

We would like to see the present exemption for producers' goods expanded from its present basis to include all goods purchased for use by manufacturers and persons fulfilling a distribution function. From a theoretical point of view, the taxing of any of these goods results in some pyramiding of tax. While the complete exemption for producers' goods would inevitably lead to some personal purchases exempt from tax through the false claiming of a business exemption, it is believed that no significant leakage of tax would occur which could not be easily remedied through simple audit procedures.

The exemption for producers' goods should be limited to those persons producing or selling taxable goods. Should the present tax be extended to tax all or specific services,then those persons providing taxable services should also be exempt from tax on their business purchases. In this way duplication of tax would be kept to a minimum.

In our view such an exemption would not create any new administrative problems and would substantially reduce problems created by the present system of exempting only equipment and material to be used directly in the

production process. Under the proposed exemption all licensed vendors would be entitled to make purchases free of tax by quoting their licence number as is now done in the case of "G" permit holders.

If the complete exemption of producers' goods was considered impractical because of the revenue loss involved, the present exemption for tangible personal property to be processed, fabricated, or manufactured into, attached to, or incorporated into tangible personal property for sale should be continued. The exemption for consumable materials and production machinery should also be continued.

It should be noted that the present exemption for production machinery and apparatus is dependent on the similar exemption in the Federal Excise Tax Act. Since this exemption has been repealed it will be necessary for the Province of Ontario to make its own rulings as to whether or not particular machines are exempt. We believe that the exemptions could be administered more easily if all goods destined for use in the manufacturer's plant were exempted rather than continuing to grant exemption only to goods used directly in the productive process. We should emphasize however that we believe that this type of limited exemption is much less desirable than a complete exemption of producers' and distributors' goods.

Farmers', fishermen's and fur trappers' implements and supplies are of the same nature as producers' goods and exemption should be continued on a consistent basis with the exemption for other producers' goods.

Food -

Most of the exemptions granted under the Ontario Retail Sales Tax Act fall within the category of exemptions granted for social purposes. Most of these exemptions are evidently granted in order to reduce the regressive impact of the tax. The chief exemption in this category is the exemption for food. Not all jurisdictions imposing sales taxes exempt food from tax although in the case of Canadian provinces, the food exemption is universal. There is some room for argument that there is no justification for food exemption in a country with a high standard of living such as Canada. In spite of this argument there are a number of individuals whose circumstances are such that a tax on food would create serious hardship. Proponents of the tax on food products believe that hardship cases should be dealt with through granting relief. While there are strong revenue arguments in favour of this position, we do not believe that the granting of relief is as acceptable from a social point of view as the exempting from tax of food products. Accordingly, on social grounds we recommend that the exemption for food products be continued in the Act.

On the assumption that food will continue to be exempt from tax we believe that all food for human consumption should be exempt and the present attempts to distinguish between various foods, candies and confections be eliminated.[1] We believe that the exemption should extend to all food and drink (other than alcoholic beverages) for human consumption and the present differentiation between consumption on and off the premises should be eliminated. If food is to be exempt there would seem to be little reason to make this distinction. Why should a Chinese dinner consumed on the premises be taxable,

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1. Regulation 1 contains definitions of candy, confections and soft drinks. At present, many exempt foods, such as chocolate covered biscuits and fancy cakes, are difficult to distinguish from taxable confections - in fact, if not in law.

whereas the same meal delivered to one's home is exempt? Similarly, why should a person who consumes more than $1.50 of food in his car at a drive-in restaurant be subject to tax, when if he were to pick the same food up at a restaurant or have it delivered to his home, he would not be taxed? It may be that the taxing of meals in excess of $1.50 is an attempt to tax luxury living. We believe that most persons eat at restaurants more through necessity than desire and in any event meals costing $1.50 at restaurants can hardly be described as luxurious. We believe that if taxes are to be levied on expensive meals this should be accomplished through an extension of The Hospital Tax Act rather than through the Ontario Retail Sales Tax Act. The present policy of taxing catered meals is a further practice which should be eliminated in the exemption of all food products. Again we are unable to see any reason why a distinction should be drawn between the consumption of a catered meal and the consumption of food products on one's own premises.

Drugs and medical supplies -

In our view the present exemptions for prescription drugs and various orthopaedic, dental and optical appliances fall into the same category as food. While from an administrative and revenue point of view, it might be preferable to tax such items, we believe that this would be undesirable from a social point of view and accordingly recommend that these exemptions should be continued.

While it may be socially desirable to exempt medical supplies from tax when purchased by individuals, the same reasoning should not apply to purchases by public hospitals. At the present time, public hospitals, psychiatric hospitals and sanatoria may purchase equipment free of tax provided that it is for use and not for resale. Ruling 15 sets out a list of items which may <u>not</u> be purchased exempt by public hospitals. This list includes general supplies, office and administrative equipment and supplies, kitchen and dietary equipment, laundry and housekeeping equipment, plant maintenance, general equipment, general furniture and recreational equipment.

This type of exemption creates administrative difficulties since it is necessary to distinguish between items used directly in patient care and items used in the general operations of the hospital. More important, however, is the erroneous assumption underlying this distinction - that equipment used directly in patient care is more essential than other equipment used in the operation of a hospital. Obviously, hospitals must have kitchens, administrative offices and plant maintenance just as they must have equipment for patient care.

In addition, the exemption of medical supplies from tax when purchased by individuals is based on the belief that sickness should not be taxed. This exemption is particularly desirable in cases where medical expenses have become a serious financial burden to the individuals concerned. Hospitals, however, are now largely financed by the federal and provincial governments - by grants from general revenues and through provincially-sponsored hospital insurance. Since hospitals are largely dependent upon federal and provincial government support, we believe that they should be subject to tax in the same way as provincial government bodies. In other words, public hospitals, psychiatric hospitals and sanatoria should receive no special exemption from tax.

Classroom supplies -

Exemption is provided for classroom supplies purchased by schools, school boards and universities and for students' supplies. We recommend that these two exemptions should be eliminated. In order that the increased costs of purchases by schools should not be added to the already heavy burden of property owners, school grants should be increased to make up for the tax paid by educational institutions. We believe that this method of granting effectual exemptions from tax is preferable to the present system which requires a number of definitions in the regulations and three pages of rulings to detail the exemptions.

Books -

The Act provides exemption for books that are printed and bound and that are published solely for educational, technical, cultural or literary purposes, as well as exemptions for newspapers, magazines and periodicals. We do not see any justification for continuing these exemptions. While it can be argued that it is socially desirable to encourage reading and in particular to encourage the Canadian publishing industry, we do not believe that this should be accomplished through exemptions provided in a retail sales tax act. It should be noted that newspapers would not normally be taxable in any event at current price levels and there would seem to be no reason why each delivery of a newspaper should not be considered a separate sale, thus avoiding the necessity of having carrier boys collect the sales tax. We realize that if our recommendation that all books be taxable is adopted tax will apply on many school text books. We believe that this is preferable to making any attempt to exempt approved text books as such an exemption would give rise to serious administrative difficulties.

Children's clothing -

Children's clothing and children's footwear as determined by the Lieutenant-Governor-in-Council are exempt from tax. The distinction between taxable and exempt clothing is determined by size with no reference to the age of the child. There is a further distinction in that some items of apparel worn by children are taxable. Taxable items include bathing suits, accessories and fabrics and patterns used in making children's clothing at home.

Because of the arbitrary size designations necessary in the definition of exempt children's clothing and the fact that some items of apparel remain taxable, serious problems are placed upon retailers in their relations with customers. Many persons logically ask why one item of clothing should bear tax while another should not, since for any one child, some items may be exempt because of size while other items are taxable because they exceed the size limitation. Others cannot understand why clothing for a big child should be taxed while small adults may purchase many items exempt.

The exemption is justified as being necessary in order to remove one of the basic necessities from tax, and to avoid any tax discrimination against large families. If basic necessities are to be exempt, there seems to be no valid reason why the exemption should be limited to children's clothing. We do not believe, however, that clothing should be exempt. Clothing expenditures by individuals, both for children and adults, are in almost every case well in excess of what might be considered to be a bare

necessity level. In any event, families who must rely upon homemade clothing for economic reasons are discriminated against since all the materials used in making clothing are taxable.

Expenditure patterns of families having the same level of income are subject to many variations because of particular needs and preferences. Because of this (as well as other factors), it has been our view that exemptions from tax should be kept to a minimum so as to avoid significant distortions in the amount of tax paid by taxpayers having similar incomes. While some large families in the lower income groups undoubtedlly require public assistance, we do not believe that the present exemption of children's clothing from tax is a logical or effective method of accomplishing this objective. In most of these cases, the relief given by this exemption can hardly be described as significant, particularly at the present rate of tax.[1]

Fuel -

Almost all types of fuels are exempted under the Act. In part these exemptions are justified on the grounds that the fuels are already taxed under another provincial act such as The Gasoline Tax Act or The Motor Vehicle Fuel Tax Act. Provincial taxes on these fuels were at their inception intended to defray the costs of maintaining roads for the vehicles consuming the fuel. Since this tax is levied on the basis of benefits derived by the users of the fuel, we do not think that it should be a factor in determining whether the fuels should be subject to a general retail sales tax. Some of the fuels exempted from sales tax can only be used for purposes of heating and the exemption of these fuels is again an attempt to reduce the regressive nature of the sales tax. We do not believe that the continued exemption of fuel is justified and believe that all fuel should be subject to retail sales tax. Fuel should, however, be considered to be producers' goods and accordingly should be exempt from tax when acquired by persons producing taxable goods.

Goods used outside the province -

Tax should not apply to goods purchased for use outside the Province and it is hoped that the provinces will soon reach agreement whereby the present leakage of tax on imports from other provinces will be substantially eliminated. Further, where goods are purchased at a retail sale and taxed in one province, tax should not again be imposed when the same goods are imported into a second province for consumption or use In this connection the present exemption for aircraft, vessels of more than 500 tons gross, and railway rolling stock should be continued but only where the purchaser is normally engaged in foreign or interprovincial trade. While trucks used in interprovincial and international cartage are subject to tax, relief is granted under the present administrative practices in respect of the use of such vehicles outside Ontario. We recommend that this practice be continued but suggest that the reduction of tax provided for on Vendor Card 32 relating to transportation enterprises should be authorized by the regulations.

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1 The average family earning $3,000 per year spends approximately 8.5% of its income on clothing. The sales tax on this amount would be $7.65 if all clothing was subject to the present 3% tax. Similarly, the average family earning $7,000 per year spends 8.1% of its income on clothing and the tax on this amount would be $17.01. See Irving J. Goffman, The Burden of Canadian Taxation (Canadian Tax Foundation, 1962) page 26.

Gifts -

The exemption for tangible personal property acquired through gifts should be expanded and all such transfers should be exempt from tax. Under the present arrangements, if a person acquires goods for purposes of gift, the purchase of those goods is taxable. If the purchaser immediately makes a gift of those goods to another person, tax is technically exigible a second time. There does not seem to be any logical basis for this.

Construction materials -

Prior to June 1, 1964, a number of organizations (including hospitals, educational institutions, municipalities and religious and charitable organizations) were permitted to claim rebates of tax paid on materials used in the construction of new buildings or municipal public works. The rebates were 1.25% of the total contract price, which was estimated to be equivalent to the 3% tax paid on the construction materials when purchased by the contractor. (In the case of roads and highways, rebates were 1.125% of the contract price.)

This system was extremely cumbersome to administer. Not only were the tax authorities required to process and verify a flood of rebate claims, but also the organizations concerned were put to the inconvenience of preparing and justifying claims for all new construction undertaken.

In order to relieve this administrative problem, the Retail Sales Tax Act was amended, effective June 1, 1964, to exempt purchases of building materials made by most of these organizations. While similar in its effect, the new exemptions are somewhat broader than the rebates previously allowed since they can be applied to materials used in alterations and repairs as well as to new construction. Religious and charitable groups, however, remain subject to the rebate system.

While relieving some administrative problems, the amendment has created new difficulties, this time principally for construction contractors. Contractors are now required to obtain a special permit before undertaking a construction contract on behalf of an exempt organization. This permit allows the contractor to purchase construction materials free of tax for that contract only. He must, however, maintain separate inventories and accounting records for each contract. If the contractor uses materials from his regular inventory in carrying out an exempt contract, he may file a rebate claim in order to recover the tax paid when the material was first purchased. These requirements of course create special auditing problems for tax enforcement officers.

We do not believe that these exemptions or rebates are justified. While they partially fulfill a social objective, which is to relieve such organizations from tax, this objective is not consistently applied. For example, public hospitals are <u>not</u> exempt from tax on a great variety of items necessary for the administration of every such organization.[1] Similarly municipalities, schools and universities must pay tax on many items.

More important however is the fact that a large part of the cost of new schools, hospitals and municipal buildings and roads are borne by the

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1. See also page 41

province by means of various grants. The determination of these grants is, of course, a matter of public policy and is beyond the scope of this study. We believe however that grants are based upon an assessment of each individual need for provincial government assistance. In practice, of course, formulae must be established. Some grants are based upon a percentage applied to certain of the actual costs incurred (school construction grants for example range from 34% to 92% of allowable costs, depending upon the "wealth" of the municipality - based upon its average assessment per classroom). In other cases, grants are based upon the size or capacity of the structure. For example, hospital grants are based upon the number of beds, not on the cost of the building. In other words the province assumes a large portion of the cost of such buildings, but this portion is seldom a fixed or immutable percentage of the actual total cost. Further, the extent of provincial grants is subject to periodic revision as public policy and financial resources permit.

There is, of course, no reason why any cost which is borne by the province (either directly or indirectly through grants) should be exempt from tax. Furthermore, we believe that the grants system represents a more appropriate means for supporting these organizations. When viewed in this way, there appears to be no reason for continuing the present exemptions.

We have concluded that these organizations should pay sales tax on tangible personal property and, if necessary, the provincial government should recognize this additional cost by adjusting future grants. The recognition of sales tax as a cost eligible for provincial grants would ensure that the imposition of tax could be accomplished without imposing any additional burden upon municipal ratepayers, particularly where provincial grants absorb the largest part of the total cost of construction. Alternatively, the additional grants might be made on a population basis, particularly for municipalities. Not only would this result in a more logical method of subsidizing these capital expenditures, it would also greatly simplify the administration of the Retail Sales Tax Act. The organizations themselves and their contractors would also benefit through administrative savings.

We have already indicated that exemptions from tax for purely social reasons should be eliminated wherever possible. Not only do these exemptions create administrative difficulties, they also tend to erode the tax base, causing higher rates of tax on the remaining taxable items. We believe that the present rebate allowed to religious and charitable organizations applicable to new buildings is an exemption that should be removed. If it is desirable, as a matter of public policy, to give financial support to these organizations, we believe that it is more appropriate to do so by grant rather than by tax exemption. In any event, the removal of this rebate would greatly simplify the administration of the Retail Sales Tax Act without creating financial hardship except in the most unusual circumstances.

Contractors

The present provisions of the Ontario Retail Sales Tax Act, together with the Regulations and Rulings with respect to construction contracts provide difficulties and anomolies in two major areas. The first and most serious area of difficulty arises in the different tax treatments of on-site construction as opposed to off-site construction.

Charges for installation of tangible personal property are not

subject to the retail sales tax. Accordingly, where a contractor instals tangible personal property in real property as part of the construction contract no tax is charged upon the installation portion of the contract. Tax is however levied upon the value of the tangible personal property installed. The difficulty with this method of levying tax is that many building components may be fabricated either on the construction job or in the contractor's shop. Where the contractor fabricates materials for the construction contracts in his shop, he is regarded as a manufacturing contractor and is required to pay tax upon the value of the goods including material, labour and overhead at the time they leave his shop for the construction project. Labour expended on the construction site is considered to be installation labour and hence is not taxable.

It is apparent that these provisions create inequalities as between different methods of construction, and in particular discriminate against prefabrication of building components. There are many examples which can be given of such discrimination. Perhaps kitchen cupboards would serve as a suitable example. Where kitchen cupboards are fabricated on site by a carpenter working in the actual building in which they are to be installed, tax would apply to the lumber and other hardware used in the fabrication. However, the labour of cutting the lumber to size and fitting it together to form a kitchen cupboard would not be taxable. If, however, this labour were expended in some other location tax would apply to the value of the finished cupboard and not merely to the material component. Similar problems arise of course in the area of many building trades including structural steel, metal work fabrication of all kinds, precasting of concrete shapes, etc.

When the federal government removed the exemption for building materials in June of 1963 the Excise Tax Act was amended to provide that certain manufacturers or producers of building components who were in competition with production of similar materials on the job site would not be regarded as manufacturers for the purposes of the federal sales tax. Accordingly, such persons pay tax on their purchase of material and they are not required to pay tax upon the fabrication labour expended in their own shops. The federal rule is as follows:

"Section 29(2b) -

Where a person

(a) manufactures or produces a building or other structure otherwise than at the site of construction or erection thereof, in competition with persons who construct or erect similar buildings or structures not so manufactured or produced,

(b) manufactures or produces otherwise than at the site of construction or erection of the building or other structure, structural building sections for incorporation into such building or structure, in competition with persons who construct or erect buildings or other structures that incorporate similar sections not so manufactured or produced,

(c) manufactures or produces concrete or cinder building blocks, or

(d) manufactures or produces from steel that has been purchased by or manufactured or produced by that person, and in respect of which any tax under this part has become payable, fabricated structural steel for buildings,

he shall, for the purposes of this Part, be deemed not to be in relation to any such building, structure, building sections, building blocks or fabricated steel so manufactured or produced by him, the manufacturer or producer thereof."

The difficulty with this type of provision is that many manufacturing contractors fabricate identical or almost identical products which may either be sold at a retail sale or used in the completion of a construction contract entered into by the contracting manufacturer. In such circumstances, it would appear inequitable to levy tax upon the retail sale based upon the selling price but to levy tax upon the material content in the case of goods fabricated for the completion of construction contracts. In any event it would be impossible for most manufacturing contractors to determine in advance when purchasing material whether or not the material would be used in the completion of the construction contract or in the fabrication of goods for sale. Consequently, there would be administrative difficulties as well as inequity created by following the same provisions as have been imposed by the federal authorities.

While in some cases it would be possible to require payment of tax based upon the ordinary selling price of the fabricated material in cases where it was used in a construction contract this would not always be inequitable since many such items are fabricated to specification. When the Ontario Retail Sales Tax Act was first introduced special provision was made in connection with goods fabricated to specification. In such cases manufacturing contractors were permitted to pay tax on the material content only. This system was subsequently revised when it became impractical to define under what circumstances goods would be regarded as being manufactured to specifications. All that was necessary to avoid payment of tax on the selling price of goods was to require that the goods meet the specifications that the manufacturer already imposed on his normal stock of manufactured goods.

There is no easy solution to this difficult problem of obtaining equality between goods manufactured on site and those manufactured off site. We believe however that a change in the whole method of dealing with contractors may in the end prove more satisfactory than attempts to piece together legislation to deal with present inequalities. We believe that the most satisfactory solution would be to regard construction contracts as a contract for the sale of tangible personal property to the owner of the real property and for the installation of this material in the real property. If construction contracts were so regarded, contractors would be deemed to be the vendors of the tangible personal property placed in construction contracts. Contractors would therefore require vendors' permits and would purchase all materials exempt from tax and would collect tax from the owner of the real estate upon sale. In most cases the general contractor would be the person charged with the responsibility of collecting the tax on behalf of the government. He would arrange to make all purchases from subcontractors and other suppliers exempt from tax by quoting his vendor's permit.

It will be immediately evident that the general contractor would face a severe administrative burden if he was required to keep track of all materials used in construction contracts in order that the proper amount of tax be collected from the owner of the property. We believe that this difficulty could be overcome satisfactorily by establishing a percentage rate to apply to the entire contract price to distinguish between installation labour and the material content of each contract. While we do not have sufficient information to develop a formula and while we recognize that the

material and labour content of construction contracts will vary somewhat according to the size and type of construction, we should point out that the Treasurer had in the past authorized rebates in respect of construction of municipal capital works, hospitals, nurses' residences, etc. at the rate of 1.25% of the total contract cost including architects' fees. This percentage had been calculated by the Treasurer to be the equivalent of 3% of the material costs involved in the construction project. It should be noted that religious and charitable organizations will be required to continue to use this percentage in the future in claiming rebates. Accordingly this appears to be an appropriate percentage for use in the collection of tax by reference to the total contract price.

If this system were to be adopted certain difficulties might arise in connection with speculative builders. For purposes of this discussion, we have considered speculative builders to be persons who construct buildings on property which they own for the purpose of selling both the land and the building to a purchaser. In some cases the sale may be arranged in advance of the actual construction of the building and in other cases the building will have been started or will have been completed before the sale is arranged. In most cases the real estate consists of a residential home but it could also be an office building, factory or apartment house. In such cases we believe the owner of the property who arranged for the construction of a building on the land in the hopes of selling it should be regarded not as a contractor but as the owner of the premises. Accordingly, such persons should not be granted vendors' permits and all persons performing contracts in connection with the construction of the building should be required to charge 1.25% of the contract price to the speculative builder. In cases where the speculative builder makes direct purchases he would be required to pay 3% tax on his purchase.

Inevitably some confusion will arise where an individual or corporation functions both as a speculative builder and as a contractor depending upon the circumstances. If the contract portion of their work consists basically of an agreement to sell land which they own and construct thereon a building more or less to the purchaser's requirements, but without detailed architectural drawings being submitted by the purchaser, we believe that such contracts should be disregarded and the contractor should be regarded as a speculative builder. Where, however, the speculative builder enters into bona fide construction contracts as a general contractor as a normal part of his business activity a vendor's permit should be issued. This vendor's permit should however be used only for those contracts which fall within the normal terms of reference of a general contractor and should not be used in connection with activities which might better be described as speculative building. In any event, if the percentage of tax to apply to the total contract price has been accurately determined by the tax authorities, there should be no significant difference between the amounts payable by a speculative builder and the amounts payable by a person entering into a construction contract with a general contractor.

The second problem arises as a result of the 1964 amendments to the Retail Sales Tax Act regarding non-resident contractors. These provisions are found in section 31(3) to (5). Undoubtedly the purpose of these provisions is to provide for the proper collection of the tax where a contractor who does not normally carry on business in Ontario performs a construction contract in

Ontario and obtains a substantial amount of material from outside of Ontario. In such cases the contractor may have completed the construction contract and have departed from the province before the tax authorities become aware of his failure to account for tax in respect of the tangible personal property used in the construction contract. Without provisions similar to those found in section 31 it would then be impossible for the tax authorities to effectively collect any tax at all in respect of the construction contract. It should be noted, however, that no problem arises with respect to materials purchased in Ontario since retail sales tax will have been paid at the time of purchase by the contractor.

While we do not disagree in principle with the purpose of this legislation, we believe that the government has not fully considered the implications of these sections.

The first point which must be made is that the requirement of a deposit or a bond in the amount of 3% of the gross contract price appears somewhat excessive. Again referring to the refund provisions of Regulation 20 it seems unreasonable to require a deposit of 3% where it is anticipated that the effective rate of tax on the contract price will be no more than 1.25%. Accordingly, a deposit of 1½% of the construction contract price would appear reasonable in the circumstances. The second point which should be noted is that a non-resident contractor is defined in paragraph 37a, Regulation 1 as an individual or corporation who has not maintained in Ontario continuously for a period of 12 months immediately preceding the signing of any particular contract, a permanent establishment defined in subsections 1 to 7 of section 2 of the Corporations Tax Act. This would apply equally to a corporation incorporated in Ontario within 12 months preceding the signing of the contract, a corporation resulting from the amalgamation of two or more companies which had always maintained permanent establishments in Ontario where the amalgamation took place within the 12 months preceding the signing of the contract and corporations which had never carried on business in Ontario before. This does not seem reasonable and we believe that the definition of non-resident contractors should be changed to exclude corporations which are incorporated in Ontario and corporations incorporated anywhere arising from the amalgamation of two or more corporations where any of the predecessor corporations had maintained in Ontario a permanent establishment for a reasonable length of time.

It should be noted that section 31(3) requires the contractor to place a deposit or bond with the Treasurer equal to 3% of the gross contract price. This deposit requirement would apparently apply equally to contracts which were to be wholly performed within Ontario and contracts in which only a small portion of the construction was to take place in Ontario. While it is difficult to visualize all of the circumstances under which contracts might arise it is possible that a contract might call for the construction of substantial facilities either in Quebec or in Manitoba or elsewhere and as a relatively minor part of the construction project require some construction to take place in Ontario. In such cases the requirement to make a deposit with the Treasurer should be reduced to cover only that part of the contract which is to be performed in Ontario.

Technical difficulties

We have previously outlined a number of areas in which major difficulties arise under the Act. There are a number of other areas in which

improvements could be made in the Act. Most of these relate to more technical provisions in the Act and Regulations, and are considered under separate headings below.

Definition of "use"

Since use of tangible personal property is one of the events that gives rise to tax liability, the definition of the word "use" is quite important in the Act. The term "use" is defined to include "storage and exercise of any right or power of tangible personal property incidental to the ownership of that property .....". The term "storage" is in turn defined in clause 12 of section 1 of the Act to include "any keeping or retention in Ontario for any purpose except retail sale or subsequent use outside Ontario of tangible personal property ....". It would appear that any person who purchased goods with the object of reselling the goods at some time in the future could be held to be storing the goods unless the goods were to be sold at a retail sale. Since"retail sale"is defined in the Act to mean a sale to a purchaser for the purpose of consumption or use and not for resale,persons storing goods in Ontario with the intention of selling them to a retailer or to any other type of purchaser except a consumer would technically be required to pay tax on the goods so stored. This is clearly not the intention of the Act. The wording of the definition of "use" should be changed to exclude any storage of goods where the goods are held for resale.

Alleged purchases for resale

Section 2(6) of the Act provides that where a person sells any tangible personal property at a retail sale in Ontario to a person who alleges he is not purchasing it for consumption or use, tax shall nevertheless be charged and the Treasurer may refund the tax on receipt of satisfactory evidence that tax was wrongfully paid. Similar provisions are found in section 2(6a) relating to sales of tangible personal property which are alleged to be machinery and apparatus.

In view of the fact that Regulation 4 provides that vendors will not be held responsible for the collection of the tax where they have received an order on which a purchase exemption certificate is indicated it is difficult to see what purpose is served by sections 2(6) and (6a). These sections of the Act should be repealed and a section substituted which would require vendors to collect tax in all cases where the purchaser is unable to provide an exemption certificate in proper form as prescribed by the Regulations.

Transfers of merchandise between related persons

Exemption from tax is provided by Regulation 19 in the case of tangible personal property transferred between certain related persons. This exemption provides welcome relief from tax in the case of many business reorganizations. In our view, however, the requirements of the regulation are far too strict and many transfers of assets amongst related companies are not exempted. For example, the regulation exempts transfers between a parent corporation and its subsidiary, but no such exemption applies to transfers between a parent corporation and its sub-subsidiary. There are many other examples of transfers between related corporations which would give rise to tax liability.

A rather curious situation results if property is transferred a second time. For example, two subsidiaries may transfer property without tax any number of times, provided that one of the subsidiaries owned the property prior to August 1961, or has since paid tax on the property. Similarly, a parent company may transfer property back and forth with one of its subsidiaries. However, a subsidiary cannot transfer to another subsidiary property which it acquired from its parent without incurring further tax. This tax could be avoided by transferring the property back to the parent, who would then transfer it to the second subsidiary - proving that a straight line may be the shortest, but not the cheapest distance between two points. Unfortunately, other considerations, such as possible income tax complications, may prevent the use of this simple avoidance technique.

These illustrations show that the present rules are capricious in their impact on intercompany transfers and because of this, we recommend that all transfers amongst related companies should be exempt from tax.

STATUTORY ADMINISTRATIVE PROVISIONS

In any taxing statute one will find a number of administrative rules set out whose object is to aid the tax authorities in enforcement and collection of the tax. In most cases taxpayers do not pay a great deal of attention to these administrative provisions, partly because the tax authorities so rarely make any use of them. When one does consider these provisions however one is struck by the immense power which is placed in the hands of civil servants. In many cases we believe that the powers granted to the tax authorities are too great especially in those cases where the Act provides for the exercise of the discretion of the Treasurer or Comptroller. We have carefully reviewed the administrative provisions and recommend that some of these provisions be changed in order to place some limits on the authority of the sales tax administrators.

Licencing of vendors

Section 3 of the Act provides for the issuing of permits to vendors and also provides that no vendor (vendor means a person who in the ordinary course of his business in Ontario sells tangible personal property to a purchaser in Ontario) shall sell any tangible personal property in Ontario unless he has been granted a permit for each place in Ontario where he transacts business and such permits must be in force at the time of any sale. Section 3(3) provides however, that the Comptroller may refuse to issue a permit to any vendor or suspend or cancel the permit of any vendor if such vendor or any of his employees contravene any of the provisions of the Act. The section affords an opportunity for the vendor to appear before the Treasurer to show why the issuance of a permit should not be refused or why the permit should not be suspended or cancelled as the case may be.

This provision of the Act makes the suspension of a permit or the refusal to issue a permit in the first place a matter for the discretion of the Comptroller and Treasurer. It should be noted that refusal to issue a permit in the first place does not have to be supported by any reasons by the Comptroller since there are no conditions for refusal as there are in the case of a suspension. Since no manufacturing or distributing business may be carried on in Ontario without a vendor's permit this section places tremendous power in the hands of the Treasurer and Comptroller. Providing the Treasurer and Comptroller act within the provisions of the Act in refusing to issue a permit or suspending it, it is doubtful that any court could interfere with the proper exercising of this discretion even though the discretion might be exercised in a way that was totally unfair. We believe that a permit should be issued to any applicant unless the Comptroller can show cause why it should not be issued, and permits should only be cancellable with the agreement of the vendor or by direction of a court. Mere suspicion on the part of the Treasurer or Comptroller of the applicants'past or prospective wrongdoing does not constitute valid grounds for denying a person the right to carry on business.

Liability of vendors

Section 16 of the Act provides that taxes collected under the Act shall be deemed to be held in trust and until the tax is remitted the amount forms a lien and charge on the assets of the collector's estate having priority

over all other claims of any person. As it is written it would appear that the section applies only to tax actually collected by the vendor but section 13 of the Act provides that where an assessment has been issued by the Comptroller the taxes assessed shall be deemed to have been collected. While it seems proper to provide that tax actually collected should be held in trust it is difficult to see how tax not collected can be held in trust.

The most serious problem raised by this section, however, is the priority it creates for the Province in the case of a bankruptcy overriding the priorities set out in the federal Bankruptcy Act. Under this provision the Province can obtain priority over first mortgages and could leave the holder of a first mortgage in an unsecured position. This situation is intolerable since there is no way in which lenders may protect themselves against the Province's prior claim. It should also be noted that the creditor in such a situation would have to assume the burden of proving the assessment wrong in order to protect his own interest. We do not believe that the public is as yet fully aware of the implications of section 16 but we would anticipate that lenders will have serious reservations as to their position when and if the Province attempts to enforce this section. We believe that it is inequitable and improper for the Province to create such a priority for itself. Accordingly we recommend that section 16 of the Act should be revised and that the Province should accept its position as a preferred creditor under the bankruptcy laws.

Bulk sales

Section 4 of the Act requires that persons disposing of their assets through a sale in bulk must first obtain a certificate that all taxes have been paid from the Comptroller. The section also provides that a person purchasing stock through a sale in bulk will be liable for any unremitted tax collected by the vendor unless such a certificate has been obtained. Under the provisions of the Bulk Sales Act all creditors of the vendor must be notified in writing of the proposed sale. In addition the proposed sale must be advertised in a prescribed manner for three weeks before the sale is to be concluded. Any creditors whose position may be endangered by the sale are thus put in a position to object to the sale. There does not seem to be any reason why the Province of Ontario should seek special protection not available to other creditors in the case of a sale in bulk. As it now stands, the sales tax authorities could unreasonably block any sale in bulk by simply refusing to issue a certificate since few purchasers would wish to risk the liabilities that might be assumed if a certificate were not issued. We therefore recommend that section 4 be repealed.

Determination of fair value

Section 2(4) provides that "where the Comptroller deems it necessary or advisable, he may determine the fair value of any such property for the purposes of taxation under this Act, and thereupon the fair value of such property for such purpose shall be as so determined by him". In view of the attitude taken by the federal courts in cases involving the exercise of ministerial discretion in income tax matters it is not clear that any valid objection may be taken to the proper exercise of the discretion of the Comptroller on questions of value. We understand that it may be impossible

to make an effective appeal against a determination of fair value by the Comptroller unless it can be shown that he has been grossly negligent in the exercise of his discretion. Since there are no restrictions upon the circumstances that must be present before the Comptroller may exercise his discretion to determine that the value is other than the actual selling price this leaves a very large weapon in the hands of the Comptroller. We believe that the Comptroller's right to determine the fair value of property should be restricted to non-arm's-length transactions or cases where goods are produced for the manufacturer's own use.

We have been informed by the tax authorities that this provision has so far been used only for the purpose of relieving taxpayers of tax in cases where the tax effect of a transaction would otherwise have been unreasonably severe. While this use of the section seems less offensive on the surface, we should point out that it is undesirable for any civil servant to be in a position either to increase or decrease the tax by arbitrary means.

Remuneration to vendors

In common with all of the other provincial sales taxes in Canada The Ontario Retail Sales Tax Act provides for the payment of remuneration to vendors for their services in collecting and remitting the tax. The Ontario Act provides for a separate arrangement to be made with each vendor although in fact remuneration is paid to vendors in accordance with ruling 1 which sets out a series of rates depending upon the proportion of taxable sales to total sales, the average amount of each sale and the amount of tax collected. The rates of remuneration vary between $\frac{1}{2}$ of 1% and 4% of the tax collected.

The remuneration is intended to compensate vendors for the costs involved in collecting the tax. While the rates set by Ontario are scaled in accordance with the amount of work involved they cannot be considered to be an accurate measure of the costs incurred by vendors. Some vendors may receive more than adequate remuneration whereas others undoubtedly recover only a part of the extra costs involved. Where the remuneration is less than the costs incurred by the vendor, this inadequate compensation is a constant irritant.

We do not understand the reasons for paying vendors for collecting tax. One of the costs of doing business is the collection, remitting and administration of taxes. Very few other taxing statutes grant any remuneration to business for complying with the law even though onerous responsibilities are placed on businesses. We believe that it is a mistake to pay remuneration to vendors and recommend that this practice be abolished. While such action on the part of the government will give rise to numerous complaints at the time remuneration is discontinued we do not believe that the elimination of remuneration will create any hardship on the business community.

Timely reassessments

Section 13(3) provides that the Comptroller may, at any time he considers reasonable, assess or reassess any tax collectible by a vendor or any tax payable by a purchaser under the Act. There is no apparent time limit on the issuing of assessments. This provision violates at least one of the principles of a good tax law in that at no time can a vendor state with any certainty that he has paid all the taxes that are to be required of him.

It apparently will be possible for the government to reassess business concerns ten or fifteen years hence. If at some future time the authorities were to reverse some ruling concerning the taxability of a particular item or items it would be possible for retroactive assessments to be issued which could have very serious consequences for vendors. There should be some reasonable protection against reassessments except in cases where it can be shown that the vendor has submitted a fraudulent return. We suggest that in the absence of fraud, reassessments should be invalid unless issued within four years of the date of the sale giving rise to the tax liability.

Notices of objection

Section 17 of the Act provides that a vendor or purchaser may object to an assessment within thirty days from the date of mailing. This time is very short indeed and there is no apparent reason why the Act should be so restrictive. The time should be extended in order to give the vendor or purchaser a reasonable chance to determine whether an objection is warranted and to set out the facts. The minimum time limit for a notice of objection under any taxing statute should be ninety days and we recommend that the Province of Ontario extend the filing date to provide sufficient time for taxpayers to review their position.

Appeals to the courts

Section 18 provides for taxpayers to appeal decisions of the Treasurer to the Supreme Court of Ontario. The notice of appeal to the Supreme Court must be filed within ninety days from the time at which the Treasurer has replied to the notice of objection sent by the taxpayer. Section 18(5) provides that the taxpayer must file security for the costs of the appeal of the court in a sum required by the Treasurer up to $400. The requirement to deposit an amount as security for the costs of the appeal could give rise to hardship in the case of taxpayers who do not have a great deal of money. Furthermore an appeal to the Supreme Court of Ontario is an expensive undertaking and it is therefore uneconomic where the amounts of tax involved are small.

We recommend that the province institute a board similar to the Tax Appeal Board to hear appeals in such a way that the cost to the taxpayer would be kept to a minimum. The institution of the Tax Appeal Board by the federal government has been of great assistance in the administration of the Income Tax Act and Estate Tax Act. While it might be argued that the number of appeals anticipated under the Retail Sales Tax Act are so few as to make the creation of a Board unnecessary, the experience at the federal level has been that when it was made possible for taxpayers to appeal tax decisions without a great deal of cost many more appeals were instituted. Since a considerable number of these appeals are decided in the taxpayer's favour, the worth of this system has been adequately demonstrated. So far as Ontario is concerned an appeal board might hear appeals with respect to capital and place of business taxes levied under the Corporations Tax Act, succession duties levied under the Succession Duties Act of Ontario, appeals from mining tax assessments, and appeals from retail sales tax assessments. There may also be other tax assessments of one kind or another (excluding municipal taxes) which could be heard and decided by such a board.

ORGANIZATION OF THE ADMINISTRATIVE STAFF

All taxing statutes, including the Retail Sales Tax Act, are largely dependent upon voluntary self-assessment of tax by each taxpayer. The legislature however, must recognize its responsibility to provide taxpayers with (a) a clear statement of the legal requirements, (b) adequate information so that taxpayers may be aware of their responsibility to collect and remit tax, and (c) an administrative staff which is competent to assist taxpayers in interpreting the statute and regulations. For a number of reasons however, (poor accounting records, carelessness, incorrect interpretations of the law and regulations, as well as attempts to defraud) self-assessment by taxpayers is not sufficient. In order to protect the interests of the tax collecting authority, some reliance must be placed upon various enforcement measures. Adequate enforcement not only produces more revenue, it also ensures equality of treatment between those taxpayers who honestly comply with all the provisions of the law and those who are less inclined to do so.

On the other hand, by failing to adequately enforce the taxing statute, the province not only loses a substantial amount of tax revenue, it permits unfair competition between taxpayers who pay the correct amount of tax and those who do not. This in turn creates a feeling of frustration and contempt towards the law.

Having accepted the principle that adequate enforcement measures are necessary to ensure the successful administration of a retail sales tax, it is apparent that attention must be given to the organization of an effective enforcement programme. Such a programme can be divided naturally into two distinct functions - compliance and audit - each of which depends largely upon a field staff. The compliance staff would be responsible for enforcing the licensing requirements set out in the Act; educating the general public, particularly retailers who are charged with the responsibility for collecting the tax; and ensuring the prompt payment of taxes due. This in turn will involve contact with delinquent taxpayers and action to collect delinquent accounts. The audit staff would be responsible for checking the returns and records of taxpayers to ensure that the correct amount of tax has been reported.

American states and Canadian provinces follow widely varying policies in the organization of their sales tax field staffs. Some place greater emphasis on the compliance function while others concentrate on the audit function. Any comparison of policies followed by the different jurisdictions is further complicated by variations between the formal organization structure and actual practice. Most however, recognize that the requirements of each function are sufficiently different to justify two separate field organizations.[1]

We believe that a unified field staff offers the obvious advantage of flexibility which at first glance would appear to be most useful, particularly in outlying areas. This advantage is however more than offset by the practical difficulties involved. Skilled accountants are necessary if adequate audits are to be performed. On the other hand, these people are difficult to obtain in

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1. All Canadian provinces levying sales tax use separate compliance and audit field staffs with the exception of Saskatchewan. Of 33 states in the United States having retail sales taxes, 5 states have a combined field staff, 2 states rely almost entirely upon an audit staff, while the remaining states maintain separate field staffs. See John F. Due, State Sales Tax Administration (Public Administration Service, 1963) page 26.

sufficient numbers and harder to keep if a large part of their time is to be devoted to routine enforcement measures. As a result, we recommend that a separate staff be maintained for each function.

Compliance section

The staff employed in this section should be responsible for ensuring that all vendors within their areas are properly licenced. This requires some screening of licence applications to ensure that there is no existing liability for tax outstanding, and that the applicants are in fact eligible for registration. A compliance officer should also visit new registrants to acquaint them with the provisions of the law.

The other major responsibility of the compliance staff is the collection of delinquent tax payments.

Because both these functions require frequent contact with taxpayers, we believe that the compliance staff should operate through regional offices.

Audit section

The audit section under the chief auditor should be responsible to the sales tax director for the selection of accounts to be checked by office or "desk" audit, and by field audit as well as for the conduct of the selected audits. The section should also be responsible for the preparation of assessments resulting from audits completed, and for the development of various audit techniques and special approaches to be used in the performance of audit assignments. Because of the necessity to maintain uniform standards throughout the province, central control of the audit function is highly desirable. On the other hand, because of the size of the province, the concentration of the audit staff at one location would mean that individual auditors would be required to spend a large part of their time away from home. This is clearly undesirable and would make the task of hiring and retaining competent personnel most difficult.

In order to retain the advantages of centralization, and at the same time permit most field auditors to work within a reasonable distance of their homes, we recommend that the province be divided into audit regions, each under the direction of a regional chief auditor. Each region should be large enough to warrant an audit staff of approximately ten auditors. This should be sufficient to permit efficient utilization of the audit staff and at the same time permit individual auditors to work within a reasonable distance of home.

Central control over the quality of work done must, however, be maintained. This could be done in a number of ways -

(1) Uniform acceptance qualifications and a centralized training programme for audit personnel would ensure that the quality of the audit staff was maintained throughout the province.

(2) Audit programmes and manuals setting out matters of policy and practice would be prepared and revised by the central office.

(3) Audit working papers could be subject to periodic reviews by senior auditors at the central office.

(4) Performance statistics by region could be used to compare different regions as well as current performance with previous periods.

(5) Assessments of tax arising from field audits could be issued through the central office. The preparation of assessments in this way would in itself assure some degree of uniformity.

(6) Centralization of audit selection, with some regional office jurisdiction, would provide uniform coverage over the entire province. In any event, central selection would be required in order to utilize newly developing scientific selection methods.

As a further step towards ensuring central control, we recommend that a central office audit staff of highly competent auditors be created. This staff would normally be responsible for the field audits of particularly large or complex accounts throughout the province, and would be available to assist regional offices on special assignments when necessary.

The size of the audit staff depends upon the extent of audit coverage desired. Ideally, it could be argued that the audit staff should be increased until the marginal cost of an additional auditor equals the additional revenue expected to be recovered through his efforts. However, we know of no jurisdiction which has reached this happy state. Judging from present difficulties facing the provincial government (as well as many other employers) in attracting skilled employees in sufficient numbers, we believe that such an objective is highly unrealistic.

In the absence then of any objective measure of the optimum size of the field audit staff, comparisons might be made with other jurisdictions which are thought to have reasonably adequate enforcement and audit programmes.

We caution however that valid comparisons are most difficult to make for three main reasons. First of all, there are substantial variations in the responsibilities of audit staffs, even in jurisdictions maintaining separate audit and enforcement organizations. (The Ontario audit staff for example was, until recently almost entirely occupied in verifying rebate claims and not on revenue audits.)

Secondly, the additional revenue resulting from retail sales tax audits (which at first glance, is a measure of the effectiveness of the programme) depends upon the audit selection techniques used. Jurisdictions which concentrate on "lucrative" audits (those where a significant recovery is expected) recover far more per audit than those jurisdictions who place some reliance on random sampling techniques. Audits should be selected by both methods but the degree of emphasis varies substantially because of the differing philosophies of tax administrators and because of staffing problems.

Finally, significant variations exist because of differing audit techniques. Some administrators rely upon brief checks, while others require more detailed examinations. The existence of large industrial and commercial enterprises within a given jurisdiction, (as opposed to small retailers) is a factor which must be considered in this connection.

We have included as Appendix D to this study, a statistical comparison of audit coverages in selected states in the United States prepared by Professor John F. Due.[1] He has concluded that a theoretical audit coverage of 5% of all accounts per year is the minimum in order to have relatively good coverage. This is based on the assumption that each auditor should conduct 44 audits per year - which is the average for the State of California. (If circumstances indicate that more than 44 audits per man per year can be conducted satisfactorily in a given jurisdiction, it follows that a greater percentage of

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1. See Appendix D

accounts should be audited annually.) Assuming that there are approximately 125,000 taxpayer accounts in Ontario, the province requires an audit staff of 142 auditors if it is to meet this minimum standard. Ontario would, however, require 325 auditors to reach the level of coverage now found in the State of California, which ranks first on the list in Appendix D. (This comparison is, of course, subject to the qualifications outlined earlier.[1])

Audit policies of the various Canadian provinces imposing a retail sales tax have also been summarized by Professor Due. Field audit staffs (excluding Ontario) range in size from 452 accounts per auditor in Prince Edward Island to 1170 in Nova Scotia. He has concluded that "with the dual system (i.e. separate field audit and enforcement staffs), a figure of perhaps 700 accounts per auditor may be regarded as a satisfactory figure".[2] On this basis Ontario should have approximately 180 field auditors. Due comments further that a ratio of two auditors for each enforcement officer is desirable. On this basis, Ontario would require approximately 90 enforcement officers, although more than this number may be necessary in the first few years following the imposition of the tax.

We strongly recommend that the Ontario retail sales tax audit staff be increased so that a reasonably adequate enforcement programme may be undertaken. We believe that such a programme would require an audit staff of at least 180 field auditors (equivalent to a coverage of approximately 700 taxpayer accounts per auditor).

The value of audit staffs in terms of additional tax collected has been amply demonstrated by both Canadian and U.S. experience.

> "Only a few provinces have analyzed the audit results per auditor and per audit carefully. British Columbia reports gain per audit of $729, and per auditor, annually of $51,885; Saskatchewan gains $65 per audit relative to about $25 cost per audit. The Saskatchewan figure is lower because of the more complete audit coverage. The more selective programme of British Columbia of course concentrates on the more productive audits. Another factor is the greater importance, in British Columbia, of large scale business.
>
> "Only a few provinces report the proportion of audits showing additional assessments. The available figures show additional assessments in two-thirds of the auditor audits in Nova Scotia and in 50% of the inspector audits; British Columbia shows additional assessments in 84% of the audits; Prince Edward Island in 73%. These figures are comparable to those in the United States."[3]

While it is difficult to predict the dollar volume of tax recoverable through a more comprehensive audit programme in Ontario, it is reasonable to expect that results should be comparable with other provinces. If the Ontario field audit staff is increased in line with our earlier recommendation results comparable to those now obtained in British Columbia should be possible. (In 1963, British Columbia had an audit staff of 47 auditors which represented a coverage of 660 accounts per auditor.[4])

As quoted above, British Columbia recovers approximately $52,000 per auditor per year which represents, at current staff levels, a total of $2,400,000 per year. Since the Ontario tax rate is only 3/5 of that in force in British Columbia, Ontario could expect a return per auditor of approximately $31,000 - $32,000 per year or a total of $5,600,000 per year if recommended staff levels

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1. See page 58
2. John F. Due, Provincial Sales Taxes (Canadian Tax Foundation, 1964) page 115
3. Ibid, page 148
4. Ibid, page 114

are achieved and if Ontario follows audit policies which are similar to those used in British Columbia. Audit recoveries in Ontario could, however, be much higher in the initial period following the implementation of an adequate enforcement programme.

At present, Ontario now has some 70 auditors, plus approximately 40 provisional auditors (most of whom are compliance officers now training to qualify as auditors). Some improvement has taken place since 1963 (when the staff consisted of fewer than 50 auditors), largely because of an active recruiting drive and a training programme designed to upgrade compliance officers. While these programmes are worthwhile, and indeed necessary, much progress is still required if even the minimum recommended staff levels are to be reached.

Individuals are attracted to careers in government service for a variety of reasons. On the one hand government service offers many benefits not always available in industry, including a certain level of prestige, a sense of public service and job stability. On the other hand salary levels are frequently somewhat lower than those available elsewhere. The Province of Ontario has been fortunate that in spite of the low salaries now offered, the government has been able to attract many dedicated and highly qualified tax administrators and assessors. We doubt however that the government can continue to attract such persons unless salary scales are adjusted upwards at least to levels competitive with the federal civil service,[1] and preferably with private industry. In our opinion, the present critical shortage of field auditors can only be resolved in this way. Low salary levels not only discourage competent individuals from entering the government service, they also result in a high level of staff turnover. It must be emphasized again that competent and experienced auditors recover in additional tax far more than the cost to the government of retaining them.

Up to this point, we have been concerned only with the total size of the audit staff. Our comments would not be complete however without some discussion of the qualifications necessary for individual auditors.

It must be recognized that a large number of audits must be made of small retail stores. Audits of this type do not require the same degree of skill as is required when reviewing larger organizations. Furthermore, highly qualified accountants cannot be retained if a large part of their time must be devoted to routine audits of this type. Accordingly, we recommend that the audit staff consist of two general categories.

The first category would consist of auditors who have had limited accounting training or experience and accordingly would have less opportunity for advancement. Newly recruited auditors who have a higher level of formal accounting education but who lack practical experience might also be included in this group on an interim basis. This group would be primarily engaged in small routine audit assignments and would be located in regional offices.

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1. We understand that the Department of National Revenue, Taxation Division (which employs a large number of field auditors), offers the following salaries:

Assessor - Class 2 (not Chartered Accountants)	$5,430 - $6,630 per annum
Assessor - Class 3 (newly qualified Chartered Accountants)	$6,450 - $7,950

We understand further that starting salaries now offered are usually $5,730 and $6,690 respectively, rather than the minimum shown above. Maximum salaries are reached after 4 or 5 years' service.

The salaries offered by the Ontario government are significantly lower by comparison. Present starting salaries for retail sales tax auditors are $5,000 for non C.A.s and $6,000 for C.A.s.

The second category would consist of auditors who by reason of experience and/or professional standing are capable of conducting audit engagements of a more complex nature. This group would be primarily engaged in the audits of manufacturers, wholesalers and large retailers. The more senior positions within the Department would normally be filled by auditors who have gained experience in this category.

In selecting auditors for either category we would not recommend that professional accounting degrees (C.A., C.G.A., or R.I.A.) be required of all applicants. While accounting degrees represent an acknowledged standard of achievement, practical experience should also be recognized, and in fact must be accepted if adequate numbers are to be found.

MUNICIPAL SALES TAXES

Reference (d) of the terms of reference under which this study is being made required: "The preparation of a detailed description of the present operation of a typical municipal sales tax in the Province of Quebec, with consideration being given as to the ease or difficulty of application."

Effective April 25, 1964, the Province of Quebec abolished the right of municipalities to impose a retail sales tax. To replace the 2% tax imposed by most municipalities, the provincial government increased the provincial tax from 4% to 6% and undertook to share sales tax revenues with all municipalities on a formula basis. One of the reasons for making the change was to assist smaller municipalities. These now receive more revenue under the formula method than they had through their own municipal tax. The other major reason for abolishing the municipal sales tax was the seriousness of the administrative problems created by the tax. These problems are discussed in this section.

No province now permits its municipalities to impose a retail sales tax, and prior to the 1964 amendments, only the Province of Quebec did so. The fact that the municipalities within the Province of Quebec were entitled to levy a retail sales tax at all probably stems from the fact that the City of Montreal first imposed its sales tax some five years before the Province of Quebec entered the sales tax field. The history of the municipal sales tax in Quebec is interesting and provides some valuable clues to a study of retail sales taxes in Canada.

In 1935 the City of Montreal was in desperate need of additional revenues. Four years of depression accompanied by low revenues and very high expenditures for relief had drained the city treasury and additional sources of revenue were desperately needed. In 1934 the City of New York had instituted a sales tax to assist it in meeting financial problems similar to those of Montreal. The then mayor of Montreal journeyed to New York and after a brief study of the New York sales tax system returned to Montreal and within a matter of months the Montreal sales tax had become law.

At that time there was considerable concern that manufacturing enterprises would not locate in the City of Montreal because of the application of sales tax to "producers' goods". As a result, the city tax provided for a refund of the taxes paid on such producers' goods to the extent that sales were made outside of the City of Montreal. This same provision was later carried into the Province of Quebec sales tax when it commenced in 1940 and it is for this reason that the Quebec sales tax rather than exempting machinery and apparatus as is done in some other provinces, continues to provide for a partial exemption for all producers' goods based upon the percentage of total sales which are made outside the province. While the Quebec authorities have attempted in the last few years to change the situation and adopt the machinery and apparatus exemption, manufacturers within the Province of Quebec are convinced that this change would increase the amount of sales taxes paid by Quebec manufacturing enterprises and have therefore resisted the change. It is interesting to note however, that in the Montreal area alone there are 15,000 manufacturers who are required to file an annual return showing their sales within the Province of Quebec and their sales outside the province in order to establish the percentage refund to which they will become entitled in respect of sales tax paid on purchases

At the time the Montreal municipal tax was introduced the Chamber of Commerce and Retail Merchants Association objected strenuously to the extra administrative burdens which were to be carried by the city's merchants in acting as agents for the collection of the tax. As a result of the objections of these groups, the Montreal City Council agreed that it would pay remuneration to vendors to compensate them for the inconvenience to which they would be put in collecting the tax. Once again this provision was accepted by the Quebec provincial government at the time it introduced its own tax in 1940. Unlike the percentage rebate in respect of tax on producers' goods however this type of provision has also been picked up by all other provinces.

In 1940 the Province of Quebec decided to enter the retail sales tax field and levy a 2% tax. Since the City of Montreal had a staff of some 110 persons who were experienced in the administration of the retail sales tax an agreement was made between the Province of Quebec and the City of Montreal under which the sales tax staff of the City was transferred to the Province. These persons were to administer not only the provincial tax but also the municipal tax which was to be collected on behalf of the City by the provincial authorities. The provincial rules followed closely the municipal rules and it was agreed between the City and the provincial authorities that the administrative procedures, exemptions and all other matters relating to the collection of the tax would be made identical so that there would be no conflict in the administration of the tax.

For many years the Quebec provincial sales tax system consisted of three parts: a 2% provincial levy, a 2% school board levy, and a 2% municipal levy. These latter two taxes were administered by the provincial authorities but were levied only at the discretion of either the school board or the municipal council. Thus, in some areas of the province the tax was as low as 2% where neither the school board nor the municipal authorities desired to impose a sales tax. In some areas the school board or the municipality would impose tax only at the rate of 1% where the revenue from such a rate was sufficient for the purposes of the school board or the municipality. Sales tax rates then, varied from 2% to 6% depending upon the municipality. This system of taxation gave rise to very serious problems. Merchants carrying on business in an area with a 6% tax rate had justifiable complaints that they were losing business to nearby merchants carrying on business in an area in which the tax rate was only 2%. Merchants carrying on business in a low rate area were not required to collect tax on behalf of neighbouring municipalities whose rates were higher. Accordingly, a person residing in a high rate area could order goods from a merchant in a low rate area to be delivered to his home in the high rate area without paying the higher rate of tax. This situation remained true until 1964 and there was no provision in the provincial Act which required a merchant to collect tax on behalf of a neighbouring municipality.

In 1961 the Province of Quebec amended its legislation and took away from school boards the discretionary right to impose sales taxes. The Province raised its effective sales tax from 2% to 4% and the 2% tax which was formerly remitted directly to the local school board is now distributed in the form of education grants by the Department of Welfare and Education. Accordingly, the discrepancy between high rate and low rate municipalities was diminished somewhat since only the 2% municipal sales tax remained discretionary.

In the Montreal area another significant change took place during the few years prior to 1964. The 13 municipalities making up the metropolitan area of the City of Montreal all agreed to impose the 2% municipal tax. Furthermore, deliveries made by merchants located within the metropolitan area to a person residing within the metropolitan area were subject to municipal tax even though the goods are delivered across a municipal border. In conjunction with this change the municipalities agreed that there would be no allocation of revenue according to the residence of the customer. Accordingly, all taxes were allocated on the basis of the locality in which the goods were sold In order to recognize the fact that the outlying communities acted as dormitories and merchants within the City of Montreal proper made a substantial part of their sales to residents of these outlying municipalities, the City of Montreal retained only 86% of the sales tax collected within its borders and the remaining 14% was distributed to the other municipalities within the metropolitan area on a population basis. The result of this change was that some of the criticisms that could be levied against the municipal sales tax were eliminated in the case of the Montreal metropolitan area.

This solution did not, however, overcome all of the problems of the municipal sales tax. There are a number of municipalities adjacent to Montreal which are outside the metropolitan area of Montreal. For example, all of the communities on the south shore of the St. Lawrence River near Montreal are outside of the mearopolitan area and consequently were not covered by the sales tax agreement. Accordingly, merchants in these areas when delivering goods into the metropolitan area of Montreal charged sales tax at the rate of 4% only. Similarly, merchants in Montreal when selling goods to residents of these areas also charged only the 4% tax. The Quebec sales tax authorities made some attempts to control the situation in the case of high value goods which are easily portable, particularly furs and jewellery. A very high percentage of the sales of these goods were made in areas where the sales tax rate was lower in order that the 2% tax may be saved. For the vast bulk of goods, however, no effort was made by the authorities to check up on persons who had goods delivered to an area other than their home in order to avoid the tax. The director of sales tax for the Montreal area estimated that the sales tax revenue lost through this form of leakage could be as high as $20 million per annum. (This estimate was based upon the increase in tax revenues as a result of the incorporation of the 2% school board levy into the provincial rate.)

It is clear from the situation in Montreal that the administrative problems involved in attempting to stop the leakage of sales tax to persons buying goods in one jurisdiction to be delivered in another are so great as to be insurmountable.

Aside from the leakage of tax which occurs because of the inability to enforce the law that requires purchasers to pay the proper amount of tax if it has not been collected by the vendor, a municipal sales tax, as constituted in the Province of Quebec, had other undesirable side effects. Because sales made by merchants in the Montreal metropolitan area to persons residing outside the metropolitan area did not bear the municipal tax provided the goods were delivered to that other area, the merchants found that the number of persons requiring delivery of even insignificant purchases was much higher than it was in other provinces. Accordingly, merchants were required to have a larger fleet of

delivery trucks and have much larger staffs concerned with the delivery of goods. In addition, there was always a problem with regard to sales clerks who were required to know the municipal boundaries in order to determine whether or not municipal sales tax must be charged.

Because of the difficulties faced by both merchants and the Quebec tax authorities in connection with the municipal sales tax in the Province of Quebec it is strongly recommended that the Province of Ontario should at all costs avoid instituting a similar system. This does not necessarily mean however, that a municipal sales tax should be avoided. It is not the purpose of this study to enquire into the question as to whether a municipal sales tax would be justified in the Province of Ontario. If, however, it is decided that municipalities require revenue from sales tax in order to meet their financial responsibilities, such a sales tax should be levied by the provincial government on behalf of all municipalities in the same way that the Province of Quebec now levies its sales tax on behalf of all school boards and municipalities. The revenue flowing from such a municipal sales tax could then be distributed on a formula basis to all municipal governments.

While this study is concerned with the structure of sales taxes only, it has nevertheless been thought worthwhile to suggest a method for the distribution of a municipal sales tax if one should be imposed. It will be noted that in the case of Toronto for example, many persons living within the municipality of metropolitan Toronto and contiguous areas will make a substantial portion of their purchases within the City of Toronto itself. Furthermore, persons living in areas adjacent to the metropolitan area will in all likelihood make the bulk of their purchases within the metropolitan area. An allocation of revenue therefore that is based upon the area in which the tax is collected will do little to assist the "dormitory" municipalities with their revenue problems. At the same time, it should be pointed out that an allocation of revenue on a per capita basis might well prove unfair to the municipal areas which are required to provide services for the merchants within their borders. Consequently, it would appear appropriate to distribute the proceeds of the municipal sales tax on a formula basis which would take into account not only the area in which the tax was collected but also the distribution of population throughout the province. A suitable formula might be to distribute one-third of the municipal sales tax to the municipalities in which the tax was collected. The remaining two-thirds might be divided amongst all of the municipalities within the province on a per capita basis. This type of allocation would appear to be more appropriate than an allocation based solely on population or solely on the area in which the tax was collected.

APPENDIX A

COMPARISON OF PROVISIONS OF PROVINCIAL RETAIL SALES TAX STATUTES

	Ontario	British Columbia	Saskatchewan	Quebec	New Brunswick	Nova Scotia	Prince Edward Island	Newfoundland
Title	Retail Sales Tax Act	Social Services Tax Act	Education and Health Tax Act	Retail Sales Tax Act	Social Services and Education Tax Act	Hospital Tax Act	Revenue Tax Act	Social Security Assessment Act
Date tax effective	September 1, 1961	July 1, 1948	August 2, 1937	July 1, 1940	June 1, 1950	January 1, 1959	July 1, 1960	November 15, 1950
Current rate of tax	3%	5%	5%	6%	3%	5%(or 1/10¢ per cigarette)	5%	5%
Charging provision	Every purchaser of tangible personal property shall pay a tax in respect of the consumption or use thereof computed. Computed on the fair value thereof.	Similar to Ontario except that tax is computed on the purchase price.	Every consumer of tangible personal property purchased at a retail sale shall pay --- a tax in respect of the consumption of such property - computed on the value of the property to be consumed.	See British Columbia	See Saskatchewan	See British Columbia	See Saskatchewan	See British Columbia
Goods purchased outside province for delivery or use in the province	taxable	taxable	taxable	taxable	taxable	taxable	taxable	taxable
Trade-in allowances	Tax applies to the net amount payable by purchaser when property of the same general kind is accepted by the vendor as a trade-in.	Ontario rule applies only if tax was originally paid on property traded in. (No restriction as to "same general kind".)	Tax applies to full fair value of property sold. No deduction is allowed on trade-in. Trade-ins may be sold free of tax if tax had been paid previously.	See Ontario	No deduction allowed on trade-ins (see Saskatchewan) - automobile trade - in allowances however may be deducted.	Ontario rule applies only if tax was originally paid on property traded in.	See New Brunswick	See British Columbia
Exemptions (see Appendix B)								
Vendor as agent	Every vendor is an agent of the Treasurer and as such shall levy and collect taxes imposed by this Act.	Every vendor is an agent of the Treasurer and as such shall levy and collect taxes imposed by this Act.	Every vendor is an agent of the Treasurer and as such shall levy and collect taxes imposed by this Act.	Every vendor is an agent of the Treasurer and as such shall levy and collect taxes imposed by this Act.	Every vendor is an agent of the Treasurer and as such shall levy and collect taxes imposed by this Act.	Every vendor is an agent of the Treasurer and as such shall levy and collect taxes imposed by this Act.	Every vendor is an agent of the Treasurer and as such shall levy and collect taxes imposed by this Act.	Every vendor is an agent of the Treasurer and as such shall levy and collect taxes imposed by this Act.

COMPARISON OF PROVISIONS OF
PROVINCIAL RETAIL SALES TAX STATUTES

	Ontario	British Columbia	Saskatchewan	Quebec	New Brunswick	Nova Scotia	Prince Edward Island	Newfoundland
Remuneration of vendors	Based upon average amount of individual sales: (a) up to $300 - 2% - 4% of tax, based upon percentage of taxable sales to total sales. (b) $301 - $1,000 - 1% of tax (c) over $1,000 - ½ of 1% of tax	3% of the first $2,500 of tax remitted and 1% of the remainder	3% on first $600 of tax 2% on remainder	2% of tax	3% of tax	3% of tax	3% of tax	3% of tax
Returns filed by vendors	Monthly-by 23rd day of month following	Monthly-by 20th day of month following	Quarterly-by 20th day of month following end of each quarter	Monthly by 15th day of Month following.	See British Columbia	See British Columbia	See British Columbia	See British Columbia
Time limit of assessments	Comptroller may at any time assess or reassess tax.	See Ontario	See Ontario	See Ontario	See Ontario	See Ontario	See Ontario	See Ontario
Notice of objection	Within 30 days of assessment	Within 60 days of assessment	Within one month of assessment	Not covered	Within 30 days of assessment	Within 60 days of assessment	Within 30 days of assessment	Within 30 days of assessment
Contractors (as defined): Construction contractors - persons who erect, remodel or repair buildings or other structures on land.	Pay tax on materials purchased	See Ontario	See Ontario	Fixed price contract - tax paid on materials purchased Cost plus contract - tax collected by contractor on price charged for material content	See Quebec	See Quebec	See Quebec	See Quebec
Manufacturing contractors - persons who manufacture or fabricate tangible personal property used in the performance of construction contracts.	Pay tax on cost of property manufactured (incl. labour and overhead), but not installation costs (on site fabrication costs considered cost of installation).	Pay tax on materials purchased only	See Ontario	Taxed as contractors - i.e. on material content only (see above)	See Ontario	Pay tax on the cost of property manufactured. "Nova Scotia seeks to tax labour of fabrication in both shop and site" - (1) but not installation labour.	See Ontario	Pay tax on "fair value" of property manufactured. Installation costs are not generally subject to tax.

COMPARISON OF PROVISIONS OF
PROVINCIAL RETAIL SALES TAX STATUTES

	Ontario	British Columbia	Saskatchewan	Quebec	New Brunswick	Nova Scotia	Prince Edward Island	Newfoundland
Ready-mix concrete operators	Deemed to be construction contractors	Not specified	Not specified	Tax paid on sale price	Not specified		Not specified	Not specified
Leased property: Where tangible personal property is leased without granting the lessee an option to purchase.	Tax payable on a percentage of rental depending upon term of lease: 6 days or less - 100% 7 days - 1 mo. - 90% over 1 month - 80%	Rental charges subject to tax in the following cases: (1) If rental contract is deemed equivalent to a sale. (2) If property had been purchased for re sale.	Rental charges are taxable, (except on property acquired by owner before June 1, 1959 and tax paid on the purchase).	Rental charges are generally subject to tax in full - except cars, trucks etc. purchased by persons exclusively for rental purposes. In such cases, lessor must pay tax on the purchase price of vehicle.	Rental charges subject to tax if goods are for intents sold or consumed. Office equipment rentals are taxable - except lessee may pay tax on purchase price.(2)	Rental charges are generally subject to tax. A deduction for service charges included under a contract is sometimes allowed - "on the IBM type of contract a 20% reduction is allowed". (3)	Rental charges subject to tax if goods are for all intents sold, or consumed. Office equipment rentals are taxable.	Rental charges subject to tax in the following cases: (1) If rental contract is deemed equivalent to a sale. (2) On sale price of goods leased by a dealer to his salesmen. (3) On property brought into province temporarily.
Where lessee has an option to purchase.	Tax is payable - (a) on the rental (as above), and (b) where option is excercised, on the option price.	When option is exercised tax is payable on full purchase price including any rental payments applied to that price. The seller is entitled to a refund of any tax paid by him on the amount of rentals received and applied to the selling price.	When option is exercised, tax is payable on full purchase price including any rental payments applied to that price, less tax paid on such rentals.	See Saskatchewan	See Saskatchewan	See Saskatchewan	See Saskatchewan	See Saskatchewan

Note: The above information is based upon a simple review of the published statutes, regulations and rulings of various provinces, and may not, therefore, correspond exactly with usual practice. Additional points discussed in a recent review of provincial sales by Professor John F. Due have been added and footnoted below.

(1) John F. Due: Provincial Sales Taxes (Canadian Tax Foundation 1964) P. 90

(2) Ibid P. 96

(3) Ibid P. 97

THE STRUCTURE OF THE ONTARIO RETAIL SALES TAX ACT

SUMMARY OF EXEMPTIONS
(x - Exempt)

	Ontario	British Columbia	Saskatchewan	Quebec	New Brunswick	Nova Scotia	Prince Edward Island	Newfoundland
Food								
Food consumed off premises	x	x	x	x	x	x	x	x
Meals - exempt only when less than	$1.51	$1.01	$0.14	x, but subject to 5% hospital tax	$1.01	$1.01	$1.01	$0.17
Candy and soft drinks	-	-	x	-	-	-	-	-
Dietary supplements	x	-	x	-	x	x	x	x
Pet supplies	-	x	x	-	x	x	x	x
Beer, wine and spirits	Taxable, except beer sold by keg or glass which is subject to special tax	Taxable, except beer sold by keg or glass which is subject to special tax	-	Taxable, except beer, which is subject to special tax	-	-	-	-
Drugs and medicines								
Drugs and medicines and medicants sold on prescription	x	x	x	x Except X-rays, gauze, bandages, etc.	x	x	x	x
Other drugs and medicines	-	-	x	-	x	x	x	-
Artificial limbs, orthopaedic appliances, equipment for handicapped persons and hearing aids	x	x	x	x	x	x	x	x
Dentures and dental appliances sold on prescription	x	x	x	Materials used subject to tax	x	x	x	x
Optical appliances sold on prescription	x	x	x	-	x	x	x	x
Farming								
Farm produce, agricultural feeds, fertilizers, fungicides	x	x	x	x	x	x	x	x
Purchase of and repairs to implements and machinery	x	x	x	x	x	x	x	x
Livestock	x	x	x	x	x	x	x	x
Insecticides	x	x	Only grasshopper bait exempt	x	x	x	x	x
Seeds	x	x	Exemption limited to farm seeds and forage crop seeds	x	x	x	x	x
Plants, including trees producing food	x, including trees sold by the Department of Lands and Forests	x	x	x	x	x	x	x
Wire, fence wire and twine	x	x	x	x	x	x	x	x
Irrigation equipment and materials	x	x	x	x	x	x	x	Only pumps, fittings and sprinklers exempt
Herbicides	x	x	x	x	x	x	x	-

THE STRUCTURE OF THE ONTARIO RETAIL SALES TAX ACT

SUMMARY OF EXEMPTIONS
(x - Exempt)

	Ontario	British Columbia	Saskatchewan	Quebec	New Brunswick	Nova Scotia	Prince Edward Island	Newfoundland
Commercial fishing								
Boats	x	x	-	x	x	x	x	x under 300 tons
Equipment	x	x	Only nets exempt	x	x	x	x	x
Production and manufacturing								
Industrial machinery	x	-	-	Exempt only to extent purchases are in respect of sales outside the province	x	x	x	-
Material consumed or expended	x	x	x	x	x	x	x	x
Catalysts	x	x	x	Exempt only to extent purchases are in respect of sales outside the province	x	x	x	x
Fuel, electricity and gas for manufacturing purposes	x	Coal and coke - exempt Fuel oil - taxable (unless subject to special tax)	x	x	x	x	x	x
Taxable items processed, fabricated or manufactured into other taxable items	x	x	x	x	x	x	x	x
Transportation								
Aircraft and aircraft repairs (exempt if used normally in inter-provincial trade)	x	-	-	x	x	x	x	x
Commercial vessels	x over 500 tons	x	-	x	x	x	x	x over 300 tons
Railway rolling stock and repairs	x	x	x includes rails and ties	-	x	x	x	x (all railway purchases by C.N.R. exempt)
Motor vehicles	Taxable, except road cleaning and fire fighting vehicles and buses in certain circumstances	-	-	Taxable, except where used in certain circumstances by municipalities and school boards	-	x	-	-
Trucks engaged in inter-provincial trade and not registered in province	Taxed on formula basis	Taxed on formula basis	Taxed on formula basis	Taxed on formula basis	Taxed on formula basis	Trucks unconditionally exempt	x	x
Freight charges f.o.b. supply point and identified on invoice	x	x	-	x	x	x	x	x

THE STRUCTURE OF THE ONTARIO RETAIL SALES TAX ACT

SUMMARY OF EXEMPTIONS
(x - Exempt)

	Ontario	British Columbia	Saskatchewan	Quebec	New Brunswick	Nova Scotia	Prince Edward Island	Newfoundland
Utilities, fuels and gasoline (other than as used in production and manufacturing)								
Gas	x	-	x	-	x	x	x	-
Electricity	x	-	-	-	x	x	x	-
Water and steam	x	Water x, steam taxable	x	Water x, steam taxable	x	x	x	Water x, steam taxable
Telegraph	x	x	x	x	x	x	x	x
Telephone - local calls	-	-	x	-	-	x	-	-
- long distance	x	x	x	x	x	x	x	x
Wood and coke	x	x	x	x	x	x	x	x
Fuel oil	x	Subject to special tax	x	x	x	x	x	Taxable, except where (1)taxed by Fuel Oil Tax Act (2)used in logging or agriculture
Coal	x	x	x	x	x	x	x	-
Gasoline, subject to gas tax	x	x	x	x	x	x	x	x
Publications and school supplies								
School text books	x	x	x	x	x	x	x	x
Bibles, prayer books, hymnals, etc.	x	x	x	x	x	x	x	-
Other books for educational, technical cultural or literary purposes	x	-	-	x	x	x	x	-
Student supplies	x	-	-	-	-	-	-	-
Classroom supplies, except pens, etc.	x	-	-	x	x	x	x	-
Newspapers	x	Taxable unless single copy price is less than 15¢	x also newspaper and printing ink	x	x when by subscription for delivery by mail	x	x	Taxable unless single copy price is less than 17¢
Magazines and periodicals by subscription	x if solely for educational, technical, cultural or literary purposes	Taxable unless single copy price is less than 15¢	x when by subscription for delivery by mail	x	x when by subscription for delivery by mail	x when by subscription for delivery by mail	x when by subscription for delivery by mail	Taxable unless single copy price is less than 17¢
Periodicals sold over the counter	x	-	-	x	x	-	x	x
Miscellaneous								
Children's clothing	x	x	-	x	x	x	x	-
Other clothing	-	-	-	-	-	-	-	-
Clay, sand, gravel and unfinished stone	x	-	-	-	x	x	x	-
Containers, labels, wrappers	x except returnable containers	x	x	x	x	x	x	x
Tobacco	-	-	-	-	-	-	x but taxed by another statute	-
Matches	-	-	x	-	-	-	-	-

THE STRUCTURE OF THE ONTARIO RETAIL SALES TAX ACT

SUMMARY OF EXEMPTIONS
(x - Exempt)

	Ontario	British Columbia	Saskatchewan	Quebec	New Brunswick	Nova Scotia	Prince Edward Island	Newfoundland
Miscellaneous (cont'd)								
Soap	-	-	x except shaving and shampooing products	x except beauty creams	-	-	-	-
Cleaning compounds	-	-	x	x	-	-	-	-
Toothpaste	-	-	-	x	-	x	-	-
Explosives purchased by a coal miner at own expense for coal mining	-	-	-	-	x	x	-	-
Equipment for religious or advertising purposes	x	-	-	x	-	-	-	-
Funeral caskets	-	-	-	-	x	x	x	-
Settlers' effects	x	x	x	x	x	x	x	x
Phonograph records	-	-	x when by subscription for delivery by mail	-	-	-	-	-
Works of art purchased by museums or art galleries	x	-	-	-	-	-	-	-
Lubricating oils	-	-	-	-	-	-	x	-
Sales								
Less than	$0.21	$0.15	$0.14	$0.11	$0.15	$0.16	$0.25	$0.17
For delivery outside the province	x	x	x	x	x	x	x	x
Of taxable goods by judicial authority	-	-	-	x	-	-	-	-
Sales to								
Federal governments	x	x	x	x	x	x	x	x
Provincial governments	-	-	-	x	-	x	-	-
Provincial crown corporations	-	-	-	-	Taxable except for Hydro-Electric Power Commission where there is a 90% rebate	x	-	-
Municipalities and agencies thereof	Taxable except for items entering into capital investments	-	-	-	Certain capital investment projects are exempt	There are rebates of tax paid for items entering into capital projects	-	-
Hospitals and nurses' residences	Taxable except for items entering into capital investments	-	-	x	-	There are rebates of tax paid for items entering into capital projects	-	-

ANALYSIS OF RETAIL SALES BY SIZE AND KIND OF BUSINESS (EXCLUDING FOOD STORES) PROVINCE OF ONTARIO - 1961

($ millions)

Annual sales volume per establishment	General merchandise (excluding food)			Automotive			Apparel and accessories			Hardware and home furnishings			Other retail (non-food)			Total		
	Total	%	Cum.%	Total	%	Cum.%	Total	%	Cum.%	Total	%	Cum.%	Total	%	Cum.%	Total	%	Cum.%
$1,000,000 and over	$506	59%	59%	$ 696	38%	38%	$ 18	4%	4%	$ 29	7%	7%	$ 210	21%	21%	$1,459	32%	32%
$500,000 - $1,000,000	75	9	68	196	11	49	21	5	9	33	7	14	130	13	34	455	10	42
$200,000 - $500,000	119	14	82	254	14	63	77	17	26	101	23	37	198	20	54	749	16	58
$100,000 - $200,000	69	8	90	243	13	76	112	25	51	108	24	61	181	18	72	713	16	74
$50,000 - $100,000	53	6	96	263	15	91	122	27	78	88	20	81	158	16	88	684	15	89
Under $50,000	36	4	100	165	9	100	99	22	100	84	19	100	123	12	100	507	11	100
	$858	100%		$1,817	100%		$449	100%		$443	100%		$1,000	100%		$4,567	100%	

General merchandise -
Department stores, mail order houses, general merchandise stores and variety stores.
Automotive -
Automobile dealers, used car dealers, accessory stores, garages, car washes etc.
Apparel and accessories -
Clothing stores, furriers, shoe stores, custom tailors etc.
Hardware and home furnishings -
Hardware, furniture, appliances, china, linen etc.
Other retail -
Drug stores, fuel oil, ice, florists, luggage, tobacco, art supplies, hobbies, music, gift and novelty, liquor etc.

Source: Dominion Bureau of Statistics (Cat. 97-503 - 1961)

PERCENTAGE OF TOTAL ACCOUNTS AUDITED ANNUALLY BY 24 STATES, ADJUSTED TO CALIFORNIA FIGURE OF ACCOUNTS AUDITED PER AUDITOR AS A NORM

Rank	State	Per Cent
Relatively Good Coverage:	California	11.6
	Michigan	9.7*
	Alabama	8.3
	Utah	7.5
	Maryland	7.4
	North Carolina	5.8
	South Carolina	5.0
Moderate Coverage:	Maine	4.9
	Iowa	4.9
	Louisiana	4.4
	Arkansas	4.3
	Washington	4.2
	Illinois	3.8
	Ohio	3.8
	Connecticut	3.7
	Nevada	3.4
	Pennsylvania	3.1
Low Coverage:	Rhode Island	2.6
	Oklahoma	2.7
	Florida	2.4
	Kansas	1.2
	South Dakota	0.8
	West Virgina	0.4
	Wyoming	0.4

*Adjusted for non-sales-tax audit work performed in audits.

John F. Due, State Sales Tax Administration (Public Administration Service, 1963) page 130.